Haute école de gestion
Genève

Investigation into the Opportunities and Risks of Art as a Financial Investment Vehicle

Jeff Koons, Balloon Dog (Orange)

Bachelor Project submitted for the Bachelor of Science HES in Business Administration with a major in International Management

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Declaration

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Geneva, the 29th of May 2015

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Executive Summary

The world of art has experienced a strong and rapid growth since the “Art Bubble” of the 1980s. This growth has been translated by the democratization of various tools to invest in art and the appeal to generate more revenues thanks to alternative investments. Consequently the art market became more volatile, leading to numerous speculative investments especially between the years 2004 and 2007. Moreover, because the art market is known to be highly opaque and illiquid, one would argue that investing in art could be risky. Therefore, because of the present opacity on the art market, the purpose of this Bachelor thesis is to present art as a particular object of investment and to enlighten the different methods of investing in art. Assessing the different rates of returns by either direct or indirect investment as well as appraising the overall risks that investors could be confronted to, this paper will guide us to final recommendations that are devoted to the mitigation of the latters. Hence, this Bachelor thesis shall be read and used as a practical guide for anyone willing to invest in art.

It is important to mention that art has a low correlation with the traditional stock market and has been recently used to diversify one’s portfolio. Thus, the question of determining art as an asset class has been raised many times. Indeed, some actors are still in disagreement and the decision to define art as an asset class still belongs to each of us. As said previously, art investment encompasses two distinct methods, the direct and the indirect one. The direct investment provides less liquidity compared to the indirect investment. The reasons of the investment vary depending on the real purpose of the individual. The direct investment would be, in general, dedicated to personal and aesthetic reasons, whereas the indirect investment through an art fund is evidently chosen for financial purpose thanks to high rates of returns. Indeed, rates of returns for indirect investment can reach more than 25% in a very short-time period. Furthermore, contemporary art generates the greatest rate of return with an average of 9% compared to Old Masters, for example, which reach only 5.52%. Finally, the risks assessed for the last part are not only related to the works of art, the different parties i.e. buyers and sellers, and the environment but also to financial risks, which are related to the time period and the amount spent on artworks.

Final recommendations defined at the chapter four are of interest for prospective passionate individuals or potential private investors. Eventually, researches were mainly done in Switzerland but also in Paris, France with the help of an independent art dealer in order to have a broader view of the current art market.

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Introduction

The world of art has always been a special world with, some would argue, a haughty atmosphere. Nevertheless, we cannot deny that the art market and its returns are somehow appealing. This complex and very private market has gained impressive value over the years, as consequence of the democratization of various investment tools that are available through auction houses, online investment platforms by means of Internet among others. Investing in art has become fashionable.

The art market has exploded over the recent years achieving astonishing heights and has seen over-exponential increases in auctions bids. The increase in global wealth and the rise of the number of billionaires affected as well the art market. Needless to say that a work of art can represent a rare and unique object, leading consequently to rise in prices i.e. value. Thus, art investment would be one of the first reasons why the art market took such a significant rapid growth. Obviously, art investors have to make sure that their "investments" provide a fruitful return, by hoping to see the value of their purchase increase with the time.

There is a strong appeal for the art investment lately. The art market raises many questions both in the way of capturing the real value of artworks and the appropriate methods to invest in this market. Moreover, there is a difficulty to assess values and a rise in concerns about the risks involved that go beyond a traditional investment. That is the reason why this paper aims to explain the functioning as well as the related risks of the art market and explain why investors are willing to invest in art and how do they proceed. It raises the question that I will try to answer through this thesis, which is linked with the opacity and the volatility of the art market; hence "What are the different methods for investing in art and how art investors can assess and mitigate risks on their investment?" Since investing in art is not an exact science final recommendations shall be read and examined as a useful tool or as a practical guide.

In the two first chapters, I am defining the global art market context since the 1980s and its structure. Then, throughout the chapters three and four, I am narrowing down my research in order to grasp the interests about investing in art through different methods of investments, the tools to do so and finally assessing the risks of it. The chapter three is a prerequisite to be able to finally combine the risks and recommendations submitted at the chapter four. For the last chapter, I am defining the potential risks faced by investors and finally draw recommendations in order to mitigate them. Eventually, in order to be more precise along this thesis, the terms “works of art” or “artworks” mainly refer to paintings and contemporary art in general.

This thesis considers the art investment as a very delicate and risky strategy of investment. Unlike traditional asset classes, the exactitude to assess rates of returns for artworks is often changing. There are few reasons that justify the latters. Studies below explain the growing interest from investors to invest in art and try to establish authentic rates of returns while assessing the potential risks.

Literature Review

Firstly, although the art market is known to be wide and to encompass numerous actors, most studies are devoted to the calculation and the assessment of the rates of returns that art generates. Indeed, there has been a growing interest among investors about alternative investment i.e. art, due to the most recent lack of performance in the traditional asset classes. Moreover, there was an increasing interest from the investors to seek to diversify their portfolio (Campbell 2008). When it comes to the mathematical approach, studies might be distorted. Indeed, the art market is known to be a very private sphere; the data gathering that is used to presume rates of return are somehow biased because only public data from auctions are collected and because expenses linked to the cost of transactions and tax collections are disregarded (Frey, Eichenberger, 1995).

Secondly, Worthington and Higgs (2003) suggest that investing in art is not generating higher returns compared to other traditional financial markets. Besides, the risks related to art investment would be much greater than expected. Actually, the outcomes found in this paper testify that the relationship between the painting markets and the equity market is bound together over a stable long-term period, alongside short and long-term “causal linkages” (Worthington, Higgs, 2003).

Finally, in further support, Bialynicka-Birula (2013) studied the comparison between the art investments and the conventional stock exchange thanks to both financial and art market indices. Different types of risks associated to art investment are assessed while examining the different returns provided by the latter. The direct method of investment is delineated by a long-term period. Findings concerning the rates of returns are characterized by high transactions costs and significant risks that evidently reduce the financial rates of returns (Bialynicka-Birula 2013).

1. The Global Art Market

1.1. Evolution of the Art Market since the 1980s

The 1980s

The art market grew rapidly and dynamically during the 80's. The art market experienced this expansion due to the various tools used by artists, and the new trends offered at this time. This worldwide boom was called the "Art Bubble". In fact, the art market never experienced such high prices before this time, the highest having been the sale of works by Vincent Van Gogh and Auguste Renoir, the highest bid auction house had ever received for a painting, more than 100 million US dollars, until then. There was a high speculative period between the years 1987 and 1989, where actors in the art market experienced unduly high prices. This was mainly due to Japanese buyers who, at the time, were undergoing a revaluation of their currency. This led to the inevitable downfall of the art market bubble, which exploded due to a strong speculation over works of art, and their prices. 1989 was an important milestone with the fall of the Berlin Wall, and the subsequent end of the Cold War. This important phase enabled a sort of market expansion, enabling artists worldwide to make their ascent and acquire recognition towards the international art market. A growing number of galleries and auction houses also grew in scope.

The 1990s

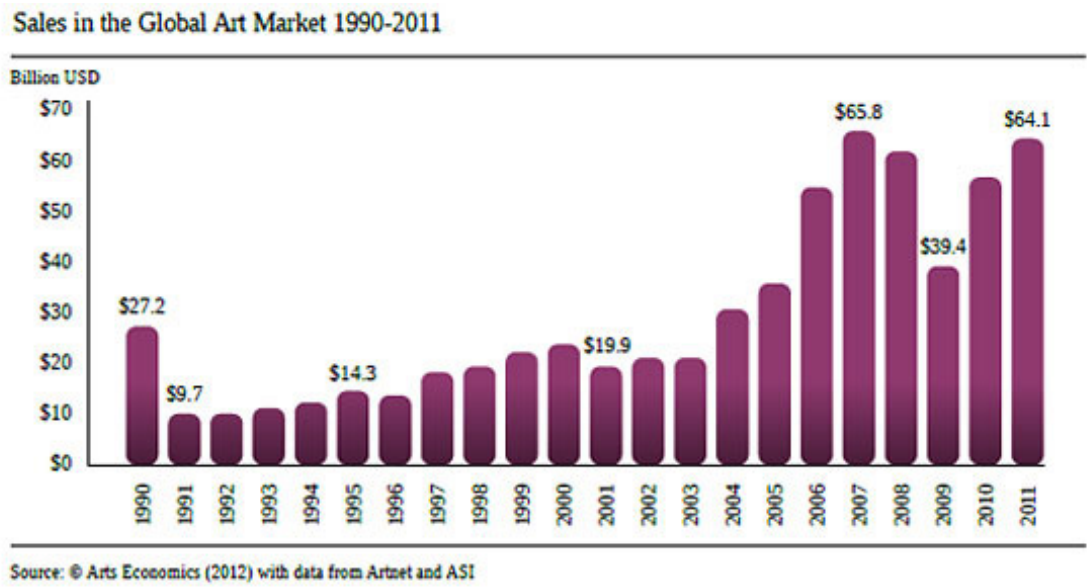
The increasing globalization of the art market created an openness in the world with the creation of different market places. In the years between 1990 and 1996, the art market weakened especially after the Japanese economic crash of the 1990s. Influential art collectors preferred keeping their art at arm's length, as decreasing confidence weakened new art deals.

The turn of the century

At the end of the 20th century and at the beginning of the 21st century, the art market was in state of shock, encompassing various changes with trigger events such as the Asian Financial Crisis of 1997 and the Russian Flu of 1998 and its consequent devaluation of the Russian Rouble. In 1999, the Internet bubble saw the light of the day. The beginning of digital era was crucial, whether positively or negatively, to all of us. There were obvious consequences on the art market since economic flows directly affect the aesthetic world. Then occurred the financial recession between 2007 and

2009 and few years later, the terrorist act of September 2011 in New York City, all critical factors that swayed the art market.

Table 1: Sales in USD in the Global Art Market 1990 – 2011



Source: Arts Economics Report, 2012

It is important to note that between 2003 and 2007, the art market was rising surprisingly. The graph above shows and illustrates well the rising prices followed by the micro-bubble of 2007. Indeed, this period was all the more marked by high speculation.

Nowadays, the art market has become such a volatile market that speculation has become part of the game. Plenty of new actors and players are now on the market, influencing trends and values. Even some hedge funds are now specializing in art investment. We call them art funds. More and more, this begs the question of whether art can now be considered an asset class.

The graph on the next page about contemporary art is extremely representative of the speculation of works of art. The unbelievable rise in prices since the beginning of the 21st century and the micro-bubble of 2007, testify of the high dynamism of the art market. Jeff Koons, the living artist, enjoys a position on the forefront of the market thanks to his highly acclaimed and kitsch masterpiece, the Balloon Dog. The market never saw such an exalted work of art that was valued and sold on November 11th, 2013, at more than 38 million euros[1].

[1] The Artprice Annual Report, 2014

Table 2: Contemporary Art: History of Record Auction Prices

Source: Contemporary Art Market 2014, The Artprice Annual Report 2014 (2014, p. 13)

Twenty to thirty years ago, the art market was much more regulated and dedicated to professional market players. Art works were also essentially used as collateral, betting the value would increase with the time.

1.2. Situation and Magnitude of the Art Market in Present Day

In the year 2014, the art auction market was far from being considered a sluggish period. Indeed, players in the art market are delighted about the notable rise in global sales. This increase has been calculated at 27% compared to the previous year, accompanied by a record number of 1679 works of art sold above 1 million US dollars[2]. In 2014, global sales in art auctions also increased by more than 21%, reaching 15.2 billion US dollars compared to 12.5 billion US dollars in 2013[3]. Thierry Ehrmann, the president and founder of Artprice.com, even characterized this phase as having "A mind-blowing result, in progression of 300% in the last decade".

The current state of the art market can be defined in one word: speculation. We are now standing at an important crossroad, where buyers and sellers are becoming tougher thanks to numerical technologies and the various current methods available to invest in a globalized market. Indeed, a gradual and continual increase in global wealth (a trend which is expected to continue) will continue to foster the ever-growing art industry.

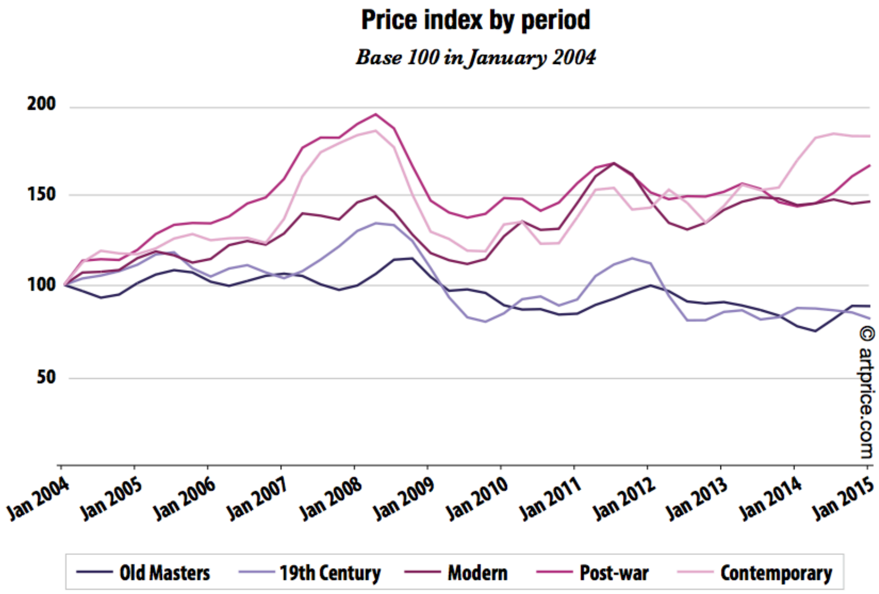
[2] The Artprice Annual Report, 2014
[3] Ref. 2

Lately, contemporary art has had a distinct appeal in the current market, above all other styles. Indeed, it has almost taken over the overall art marketplace.

The following graph shows a strong tendency to speculative investments between the years 2004 and 2007. During this period, the price index for contemporary art demonstrates a 48% increase followed by 3 years of constant decrease. Since early 2015, we can clearly observe a substantial increase of 60% in the price index that started up again in 2010 revealing the regrowth of high volatility and speculation[4].

The 2013 contemporary art sales of the two leading auction houses, Christie's and Sotheby's represented 44% of the global art sales and 27% of all sales of impressionist and modern painters. It is in this era that the contemporary artist, Jeff Koons, became the darling of art speculation with the adjunction of his art, the orange Balloon Dog, for 38'859'600 euros at a record setting by Christie's in New York[5].

Table 3: Price Index by Period



Source: The art market in 2014 (2014, p. 6)

Two years ago, in 2013, global art sales rose to 47.4 billion euros, of which 1.5 billion euros was entirely invested in contemporary art. This is representative of an increase of 150% in value of the art market, compared to the last decade and the 12% increase in the art industry from the year 2012 to 2014[6].

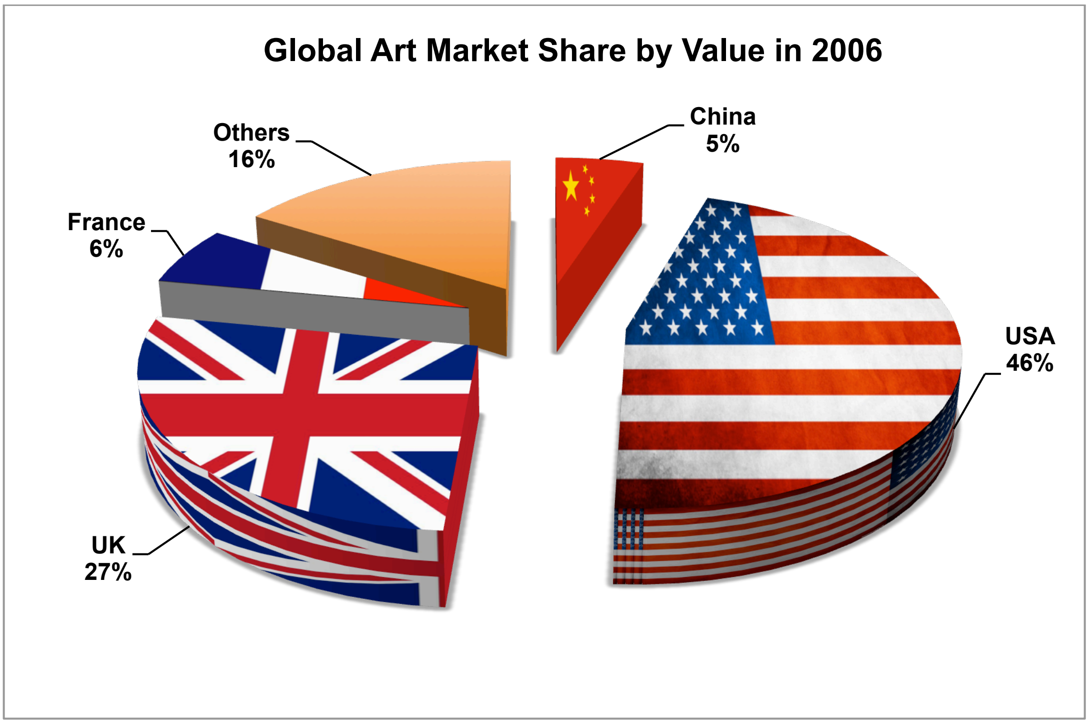
[4] The Artprice Annual Report, 2014
[5] Ref. 4
[6] Ref. 4

Evidently, the art market of the 21st century is in total evolution. Living artists such as Gerhard Richter, Jeff Koons, Richard Prince, Urs Fischer or even Cindy Sherman are able to market and sell their works effectively. Above all, unlike struggling artists of previous eras, they can enjoy their acclaim and success during their lifetimes. By now, artists Jeff Koons, Jean-Michel Basquiat and Christopher Wool are the most influential artists according to their 22% global shares on the contemporary art market (Artprice annual Report 2014).

1.3. Geographical Distribution of the Art Market

The pie chart below demonstrates the global art market share by value in term of sales in 2006 and in 2013. The two main countries that were accountable for the art market share in 2006 were the USA in first position with 46% followed by the United Kingdom with 27% shares. The others with 16% include Germany, Switzerland, Italy, Sweden and Austria.

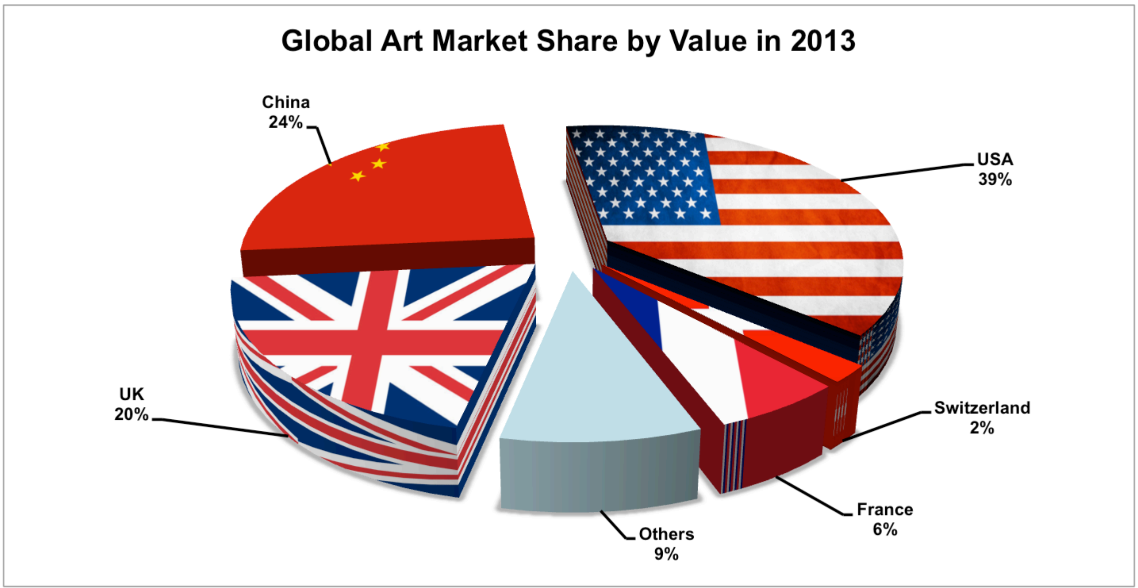
Figure 1: Global Auction Art Market Share by Value In 2006



Source: Compiled by Ludovic Dugué, based on Arts Economic, 2014

What is interesting to note is the change seven years later. The USA lost 7% of its share, as did the United Kingdom. Somewhat surprisingly, China gained 19% of the shares. It is an increase of more than 4.5 times their previous share.

Figure 2: Global Auction Art Market Share by Value In 2013



Source: Compiled by Ludovic Dugué, based on TEFAF Annual Report, (2014, p. 22)

In 2007, China overtook France to become the second largest country in global art market share. Indeed, Chinese art represents 23% of the total auction sales by category in 2013 (Deloitte 2014). Needless to say, China emerged rapidly in this market, leaving the United Kingdom behind.

In 2011, China caught up with the United States by 1%, but fell one year later after its economy slowed down.

New York City is famously known as the capital of art, similarly to London, which is often seen as the European capital of art. Both have historically been art hubs encompassing an important number of galleries and museums. We might see in the future an increase of new and different art hubs in emerging markets, such as China or even Hong-Kong where the wealth and the auction sales trend have remarkably increased.

New York and London galleries especially have shifted their way of creating value; from investment based on aesthetic passion to investment that is driven by a conscious understanding of return on investments.

The chart below gives an interesting representation of the cities where the sale of contemporary art is most important. New York is still ranked as number 1 in the world, however recently numerous Chinese cities have caught up, with Beijing now ranked number 2. Indeed, the dynamism of cities has changed dramatically in the past 10 years to give place to competitive Chinese cities. These changes are obviously correlated with an increase in global wealth, particularly with a Chinese elite that controls a larger portion of the art market now than ever before.

Table 4: Top 10 Cities – Contemporary Art 2013 – 2014

Top 10 Cities - Contemporary Art (2013 - 2014)

Rank	City	Auction Turnover
1	NEW YORK	€541,331,656
2	BEIJING	€299,642,537
3	LONDON	€230,325,132
4	HONG KONG	€187,278,699
5	SHANGHAI	€39,386,327
6	PARIS	€23,113,570
7	GUANGZHOU	€21,573,242
8	NANJING	€19,047,333
9	HANGZHOU	€14,831,548
10	TAIPEI	€9,965,738

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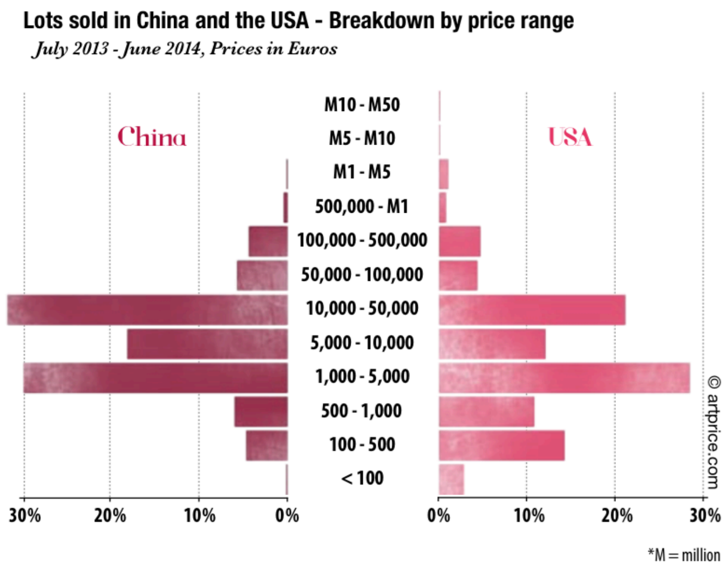
Source: Contemporary Art Market 2014, The Artprice Annual Report, (2014, p. 22)

1.3.1. Competition between the USA and China

Back in 2010, the US share of the art market amounted to 29.9% and China's amounted to 33%. According to Artprice, the United Kingdom kept its share. This is representative of an increase in the market share of 30% for the USA, and a net decrease of 27% for China (The Artprice Annual Report, 2014).

Table 5: Lots Sold in China and the USA – Breakdown by Price Range



Source: Contemporary Art Market 2014, The Artprice Annual Report 2014 (2014, p. 21)

The graph above illustrates well how these two countries engage in furious competitiveness. Indeed, the USA is home to numerous influential collectors, but is also the country where the numbers of transactions are highest. The two countries alone generate 78% of global revenues of the art market. China alone represented 7.5 billion euros in auction house sales last year (The Artprice Annual Report 2014).

Comparing the price ranges for amounts spent on works of art in both countries illustrates their economic dynamism. Looking at the top of the previous chart, the USA can be considered to be the first ranked, as they sold between 1 and 2 million. Chinese' lots are better sold in the range of 50'000 and 1'000 euros.

2. Structure of the Art Market

The art market in 2015 is following its continually increasing trend, and continues to be a concentrated market with high volumes of exchange. Compared to other traditional markets, art differentiates itself by embracing fewer buyers and sellers compared to the substantial numbers of artworks pouring into the marketplace. In order to well define the structure of the art market, the following sub-chapters are divided into two categories. The first one is about the supply and demand that obviously governs the marketplace, and the second part is about the two art markets; the primary and the secondary markets.

2.1. Supply and Demand

Among other things, the marketplace is principally based on the law of supply and demand, and encompasses numerous actors. It is critical to differentiate the main well-defined global actors:

The supply, namely:

- Artists and their intermediaries, such as galleries, auction houses (that obviously create demand) and finally, online platforms and art dealers.

The demand, namely:

- Private investors, so-called art enthusiasts, private investors seeking exclusively return on investment, such as individuals, family offices or art funds, and lastly institutions, such as Foundations, museums and collectors (who hold the supply).

Please note that the list above is not exhaustive and principally includes major actors of the art market.

The law of supply and demand that governs the art market brings together a much smaller amount of actors compared to the traditional stock exchange. Indeed, the art market is governed by influential actors such as art collectors and major auction houses, namely Sotheby's and Christie's. These prominent actors thus have the possibility to create the "demand". Therefore, they have the possibility to propose and organize special, specified sales with specific artists or types of works that would most probably influence buyers by creating demand.

2.2. Primary and Secondary Market

Having differentiated the crucial supply and demand actors of the art world, we must now define the two indispensable "steps" of the art market, manifested in the primary, and then the secondary market, as explained below:

Primary Market

- The primary market, as its name defines it, is the market for the first sale. Obviously this market is not well accessible particularly for artists that are either unknown or only about to get known on the marketplace. Art dealers and direct selling parties, most commonly organized by the artists, are where offer and demand meets.

In this market, since the artists are not necessarily known, the prices will be set based on personal relations and individual appreciations since the true price of an artwork is often not yet well known. On the other hand, when artists become publicly known, prices tend to increase due to a speculative rise in value of their works.

Secondary Market

- The secondary market represents the resale of works of art. Major actors on this market are local, national or international auction houses. Besides, art dealers also have an influential hand. This market is shaped by a highly different level of dynamism and concentration in comparison with the primary market.

The secondary market is where most value is created. To be considered part of the secondary market, an artwork has to be sold at least once. As written above, this market is mainly driven by auction houses, which will only be interested in value creation. Naturally, this market is highly speculative and of course leads to the resale of artworks for absurd amounts. It is interesting to specify that some actors that are intermediaries to the demand, such as private investors, are exclusively looking for generating profit over artworks.

2.3. Major Actors of Influence

In order to fully explain the art market's structure, it is necessary to identify certain actors. I decided to choose the major ones, such as artists, auction houses, galleries and art fairs in order to define the most important lines of the art market ambit.

2.3.1. Artists

The artists have a crucial place in the art market structure; they are the fuel. They partly define the way the art market will act and react depending on the artworks they create and how unique they are. However, their control is very limited since they cannot concretely influence prices of their artworks, nor their popularity.

In order to distinguish between types of artists, I decided to rely on the book "Le marché de l'art contemporain", written by Nathalie Moureau and Dominique Sagot-Duvauroux. Below are some factors that affect how art buyers evaluate an artist:

- Time spent on art activity
- Quality of work
- Acknowledgment by peers
- Gain/benefit derived from the activity
- Renown
- Being part of a group or not
- Qualification skills
- Subjective self-identification

Most of the time, artists rely on galleries to be displayed, to have access to buyers, or simply to grow in repute.

The graph on the next page is representative of the ten most influential contemporary artists that saw, or not, their works of art sold through auction houses. We call them the "Blue-Chip" artists.

Table 6: Top 10 Contemporary Artists 2013 - 2014

Rank	Artist	Country of Birth	Auction Turnover	Sold Lots	Top Hammer Price
1	BASQUIAT Jean-Michel (1960-1988)	USA	€162,277,646	85	€22,527,700
2	KOONS Jeff (1955)	USA	€115,039,516	52	€38,859,600
3	WOOL Christopher (1955)	USA	€61,759,209	54	€17,561,550
4	ZENG Fanzhi (1964)	CN	€59,608,941	64	€15,172,800
5	DOIG Peter (1959)	GB	€33,925,162	70	€10,985,920
6	PRINCE Richard (1949)	USA	€28,132,760	63	€5,451,750
7	KIPPENBERGER Martin (1953-1997)	DE	€25,902,248	71	€11,993,850
8	LUO Zhongli (1948)	CN	€24,740,054	91	€4,518,200
9	CHEN Yifei (1946-2005)	CN	€22,778,655	38	€6,638,100
10	ZHANG Xiaogang (1958)	CN	€20,785,876	42	€7,806,980

Source: Contemporary Art Market 2014, The Artprice Annual Report (2014, p. 53)

2.3.2. Galleries

Nowadays, different types of art galleries exist: private, public and online galleries. The latter began to spread quickly over the past 15 years. The advantage of online galleries is that works of art are accessible throughout the world without any constraints. Obviously, costs are very reduced for online galleries because they can virtually display material artworks in an intangible manner.

Most of the time, galleries are unearthing emerging artists, thus acting for the primary market. Their role is mostly to set the actual trend of the art market while continuously signing new artists. Other galleries only focus on the secondary market. These galleries play a critical role in the art market in determining the value of art.

According to Nathalie Moureau and Dominique Sagot-Duvauroux, 70% of galleries were responsible for most sales of contemporary and modern works of art in 2010. The different types of galleries are described, according to Nathalie Moureau and Dominique Sagot-Duvauroux, as:

- Galleries specialized in the secondary market
- Galleries that lease space for artists
- Galleries that ask artists to contribute towards promotional fees
- Galleries that assume the risks (hence that do not ask artists to rent space, but that debit a percentage on sales)

2.3.3. Auction Houses

There are four main auction houses governing the current art market, Christie's, Sotheby's, Poly International Auction Company and Phillips. Sotheby's and Christie's are the oldest ones on the market and are accountable for 80% of overall art sales. According to Bloomberg, between 2013 and 2014 Christie's increased its sales by 12% with a turnover that amounted to $7.7 billion, and Sotheby's increased by 18% with a turnover that amounted to $6 billion (Romano 2014).

Table 7: Top 10 Auction Houses – Contemporary Art (2013/2014)

Top 10 Auction houses - Contemporary art (2013/2014)

Rank	Auction house	Auction Turnover	Sold lots
1	Christie's	€528,737,762	3,225
2	Sotheby's	€347,820,789	2,327
3	Poly International Auction Co.,Ltd	€140,201,645	2,344
4	Phillips	€89,501,946	1,728
5	China Guardian Auctions Co., Ltd.	€43,074,790	888
6	Beijing Council International Auctions	€36,665,178	528
7	RomBon Auction of Beijing	€18,585,969	996
8	Beijing Hanhai Art Auction Co.Ltd.	€14,456,793	578
9	Xiling Yinshe Auction Co.Ltd.	€13,558,853	413
10	Beijing A & F Auction	€10,901,755	206

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Source: Contemporary Art Market 2014, The Artprice Annual Report (2014, p. 24)

2.3.4. Art Fairs

Art fairs and art exhibitions are art shows occurring throughout the year at different locations, mostly supported by major institutions. For the most part, each fair has a specific defining feature. Some are more based on contemporary art, such as Art Basel, other focus on modern or young artists. Many galleries are represented in art fairs, while many art dealers peruse the aisles to conduct research on potential major artists and to find inspiration.

2.4. Factors Influencing the Art Market

As we know, the art market is affected by multiple series of factors that influence its behavior and trends. Speculation and volatility are elements that have a particularly strong impact over the trends and investments made in the art world. On the next page are some non-negligible factors that are important to delineate and underline.

a. Increase in Global Wealth

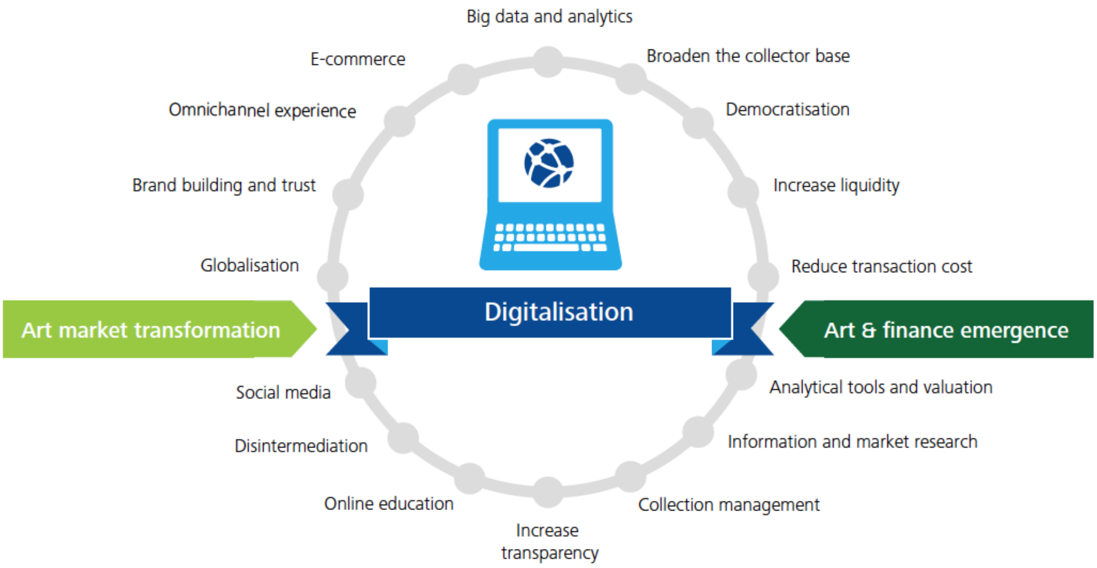
Increase in global wealth has a direct influence over the art market; it drives the art market. It is even more distinct in emerging markets, such as Asia or the Middle East, where the effect of an increase in income, shows even more impact. A similarly noticeable effect is the "Wealth Creation Effect"; the creation of wealth by the stock market has a correlated impact over the prices of art.

b. Technology - Online Platforms

Public online platforms and websites available for the purchases of art, such as auctions and market places, have grown remarkably fast over the past years. Even though most popular companies related to art are still physical active companies, many of them decided to close their physical art-holding venues to enter the virtual world. Undeniably, these online platforms enable investors and/or enthusiasts to purchase fine arts with much more confidence than expected, since online platforms offer a wider range of works of art. This provokes a shrinkage of the gap between buyers and sellers. Indeed, online platforms provide a carefree usage, more transparency, propose lower costs of transactions and offer important information to the potential buyers. The latter, of course, allows access to greater information concerning the artwork itself, such as affording a better vision of the work and its details that would have not been possible at a physical auction.

On the following page, we can see the benefits afforded by this technological trend:

Figure 3: Global Online Art Industry Trends 2014



Source: Deloitte, Art & Finance Report (2014, p. 101)

More liquidity and consolidations are expected to arise in the near future followed by an obvious increase in opportunities thanks to risk assessments and valuation of the works of art. This is why the digital art world, the new world, is substantially growing in magnitude and should be precariously taken into consideration.

The list below is the non-exhaustive names of main online platforms specialized in art transaction:

- Artprice.com
- Artnet Auction
- Artfinder
- Chrisite's
- Saffron Art
- Saatchi Online Artspace
- Blacklots
- Paddle8
- New Blood
- Minigallery

c. Death Effect

The consequence of the death of an artist is undoubtedly not without consequences on the art market. The outcomes are multiple and diverse; of course the supply of art is henceforth ended and the price movement will be the result of this shift in supply. Manifestly, the price will increase right after the death of the artist and decrease over the time. Studies support this. Surprisingly, demand will also be more affected by this event, which is mainly due to the concentration of attention and curiosity from individuals and the media. There is a distinct correlation between the death of an artist and the rise in prices for his/her works of art.

> *"The death effect is a demand rather than a supply phenomenon. It is not the fixed supply per se, but the after-death certainty that a supply or a supply-rate will be reduced to zero that stimulates demand for an artist's work. In short, the demand problem facing the durable goods monopolist may be applicable to artists as well."* (Ekelund, and al, 2000)

d. Diversity of the Works of Art

The art market is plentiful; the majority of artworks are unique pieces and some can be in sets or collections. The uniqueness of the some works of art may be considered as non-substitutable and of course, irreplaceable. Indeed, such a heterogeneous characteristic proves that the art market cannot be considered as similar as a classical market, making the art market a thrilling place to be in and to mix with.

e. Monopolistic Situation

As established above, because works of art are predominantly non-substitutable, the art market is considered monopoly-shaped. The acquirer creates a monopolistic situation that allows him/her to fix a selling price, and to retain the work of art so as to effectively block access to it from other interested individuals. This situation occurs repeatedly since, as previously explained, each art piece is considered unique and irreplaceable in nature, on the whole. This conviction that art is unique in nature renders the art market one of its kind and diametrically different from other traditional markets.

3. Art as an Investment

Investing in art can be very complex. Information available on the market is the key resource for anyone who is willing to engage in art investment. One would argue that investing in art and purchasing works of art are mutually exclusive actions. We will see later that investing in art is perceived as a mathematical/statistical operation, for a short or long-term objective period, focusing on profitable return on investment.

3.1. Art as an Asset Class

Having described some of the history and evolution of the art market, followed by a thorough identification of its important and very unique structure, this following sub-chapter will help us to understand better how art is situated amongst other financial trends.

Of late, speculation has arisen amongst actors across the art world, questioning whether art can be considered an asset class, particularly as its use is now shifting from enjoyment to value creation. Art pieces used to be bought for enjoyment, for the pleasure of the eye and for prestige. Undeniably, art hold a certain value, which increases sharply in the long-term.

This leads us to ask whether art is a convenient good for investment.

Traditional financial theories define an asset as a good that produces income. As a counter example gold produces no income, nevertheless it is still considered a financial asset. Commodities, for example, have become a particular class of investment assets as well. Art does not produce income when bought, but could at the time it is resold. Its financial performance is created only at the resale. The next question that must to be asked is whether investors can approach art as an investment, and if they can be considered as a new unconventional type of financial asset.

3.1.1. What Is an Asset Class?

An asset class is a group of securities that have a similar financial characteristic; they act similarly and are subject to the same laws and regulations (Investopedia 2015). The only three assets classes are:

- Equities
- Fixed Income
- Cash

The first process when investing elsewhere than art, is:

- Objective
- Liquid
- Transparent
- Mathematical

And the second process, when investing in art, is:

- Subjective
- Illiquid
- Opaque
- Speculative

These are two different and properly distinct worlds. Indeed, the art market exists to convert a tangible cultural asset into fungible values.

As such, to answer the question of whether art is considered an asset class is actually very personal and subjective; it is difficult to establish a consensus.

3.1.2. Is Art an Asset Class?

1. ***Argument in Favor of Art as an Asset Class***

Works of art can hold value and is a mean of value storage. We will see later that overall, art generates positive returns on investment. It is an international market that encompasses a quite large and increasing part of the ultra high net worth of individuals (UHNWI). Moreover, some financial tools are already accessible in the art world, such as art funds, art lending (so-call art loans) and art indices (Dawance 2015).

2. ***Argument Against Art as an Asset Class***

There is a clear asymmetry between the art sellers and the buyers. Most of the time it is obvious that the prices, the supply and the demand are difficult to access and to assess for most of the people interested in art. Indeed, what makes it difficult is the low transparency and access to information. Finally, the transaction costs are quite high, usually between 20% and 25% and the price equilibrium process is unstable, since the elasticity of supply and demand is irregular (Dawance 2015).

In the point of view of the collectors, they consider the works of art as a special but financial asset, nonetheless. Some will say that they are buying art for collecting purposes but with a view to investment as well. Most galleries would explain that their clients do exactly this.

Most bankers would answer that they are not yet considering art as an asset class, per se. However, it is an important and growing part in the client's banking asset, as bankers are increasingly conducting transactions, the retentions and the transmissions of artwork on behalf of their customers.

3.2. Investing in Art

Since the 1980s, investing in art has become an investment vehicle. Works of art sold at auction increased phenomenally. Investing in art can be a fancy investment, however not everyone would be keen to do so since it can be seen by some, as a dubious or even ambiguous investment. Indeed, art does not deliver the same value as a bond or even a stock option can provide. Thereby, art investment permits investors to diversify their portfolio, to invest in an illiquid alternative vehicle. Most of the time, because art is considered as illiquid, investors purchase works of art to keep them for several years; the majority will store them between 5 to 10 years. Nevertheless, it could happen that the work of art is sold after a week or 6 months, or even be stored for much longer time, depending of the buyer's financial objectives. People are fascinated with art; it is a physical good that can be appreciated against a wall, or in the living room, in opposition to a stock option. Although stock options or bonds mostly deliver a constant return depending of the economic situation of a company or a country, art does not dispense measurable constant returns. The yields generated by art investment are tightly correlated with supply and demand for that particular piece and obviously art market trends. We will soon delve into how the returns are affected by these trends.

Obviously, the tangible nature of this kind of investment appeals to people. As explained previously, art investment allows the investors to diversify their portfolio (Powley 2013). Investing in art is associated with high speculation, which increased by 12% in 2014 (Deloitte 2014), and is obviously a risk. We can assume that the art market nowadays is highly volatile; that the value of an artwork is subject to trends and other factors like the global economic situation. The fact that people were willing to invest in art led to the creation of various possible forms of investment. On the one hand, art funds began to surface, as of 2008. On the other hand, many art indices started to develop also, in order to find solutions to stay profitable and to decrease the opacity of the art market.

If a person is willing to be rational about his investment, he will be able to put the value on that investment at any given time. In actual fact, the market is far from being liquid; the raw data are difficult to obtain in such a close market. Additionally, works of art are not fungible.

Back in the 20th century, people were using art as collateral, betting that the value would increase with time. In the last 20-30 years, it transformed into a more regulated, developed and professional market. Obviously, thanks to current technological tools, the market is now getting much more transparent than three to five years ago. However, some would argue that there are still a paucity of data available and that the market is very blurry.

If we take the example of the contemporary art market, it skyrocketed by 50% in terms of sales (The Artprice Annual Report 2014). The value that was given to works of art was not the only factor; it was the type of investor that created such a turn.

3.2.1. Determinants Related to the Change

The study by Bruno S. Frey and Reiner Eichenberger, named "On the Return of Art Investment Return Analyses", differentiates works of art from consumption goods. "*The return from owning art does not only consist in price rises but also in the psychic return, i.e., art is also a consumption good*" (Frey, Eichenberger, 1995). As reported by the two authors, someone who is willing to purchase art will either rationalize the purchase as a financial motive or choose art as a consumption good. The five determinants stated below affect the marginal choice of the buyer between the two choices made available to him, whether consciously or unconsciously.

The five determinants that need to be taken into account when pondering this choice are:

1. ***The Change in Risk (Price Variation)***

This issue is treated differently depending on the point of view and the situation of the person. Indeed, a collector will not directly be affected by this issue since his goal is not about value creation but only about passion. On the other hand, a pure investor is only looking for profit creation and will be directly affected since variation of prices implies volatility risks.

2. *The Change in Cost*

Here, the costs refer to the selling costs, the costs of storage or insurance, amongst other things. Thus, a collector will not be affected by this change since his/her goal would not be about selling works of art, but only about holding art to enjoy it. On the contrary, the speculators will tend to act (and sell) uniquely when the situation is profitable to make a return on investment.

3. *Unexpected Change in Taxes*

Art is known to be beneficial to investors depending on their country of residence (. i.e. France). Indeed, governments do not necessarily tax art objects on transactions. Thus great opportunities are made available to investors.

4. *Unexpected Change in Regulations*

This point refers to changes applied by governments that attempt to control art transactions by defining them as financial transactions that are therefore taxable. Obviously, collectors are not primarily concerned with these changes if finances are irrelevant to their art intake.

5. *Change in Genres and Tastes*

A change in cultural genres and tastes directly affects the art market and its participants, especially speculators. These types of evolutions will automatically lead to price variations. It is very difficult to assess such changes; this is why an investor is noticeably touched by theses changes.

3.2.2. Information to Consider when Investing in Art

The art market does not provide any direct value; hence it is very difficult to mark-to-market. That is why investors have to take into account careful considerations when investing in art.

When beginning to invest in art, all information given is crucial. The person has to develop a wide network through galleries, online galleries, auctions and art fairs mainly. Should he have the opportunity, meeting the artists is also important in order to discuss about his artwork. The person has to be aware that investing in art is not risk-free, like any other investment. As said previously, art is illiquid and the market is bumpy and unpredictable. That is why it is recommended to invest over a medium to a long-term period, but definitely not for a short-term period, if the person is looking for great returns. Looking for advice from experienced people working in the field must not be neglected. It could be also delivered by specialized firms such as the Fine Art Wealth Management or The Art Investor's, for instance. Having a good expertise is essential to guarantee an appropriate return.

Lately, banks are developing departments dedicated entirely to art advisory services for the clients who are increasingly using their art portfolios as collateral. In recent years, 36% of banks are considering or already giving art loans (Powley 2013). There are two extreme players to be noted:

1. Asset-based lending (ABL), which typically provides collateralized credit facilities to borrowers with high financial leverage and marginal cash flows.
2. Cash flow lenders (banks looking at the client cash flows, taking securities to lower the risks).

3.3. The Two Types of Investments

There are two kinds of investments that exist.

1. <u>Direct Investment</u>

The investor acquires the work of art. Then the question about the identity of the holder/buyer is raised. Legally, there are two kinds of investors. The first is any individual who buys art for himself. The second is a legal entity such as a company or a foundation that acquires the work.

2. <u>Indirect Investment</u>

Indirect investment is based on an indirect acquisition of the artwork. An intermediary, such as an investment fund, will buy works of art on behalf of investors.

Finally, these kinds of investments are purely done from a financial point of view. Investors are thus expecting a return on investment by the resale of the work of art. It is important to note that certain art funds may also associate a logic of passion to these otherwise purely financial investments (Pearlstein, McCullough LLP 2014).

The two types of investments in art aforementioned are the direct and indirect methods. It is important to compare the two of them in order to have a global view and to evaluate the different factors associated with them. These factors include the degree of liquidity, the time frame, the kind of profit it delivers, and finally the objective of buying art (whether for passion or only for profit) (Bialynicka-Birula 2013).

Table 8: Distinction between a Direct Investment and an Indirect Investment

Type of investment	Direct investment (by physical ownership or by a moral person)	Indirect investment (shares in an art fund)
Liquidity (1=low/5=high)	1-2	4-5
Time Frame	Long-term period	Erratic
Revenue/Profit	Profit / Loss	• Dividends • Interests
Objective	Personal reason i.e. consumption good and aesthetic reasons	Financial purpose: return on investment

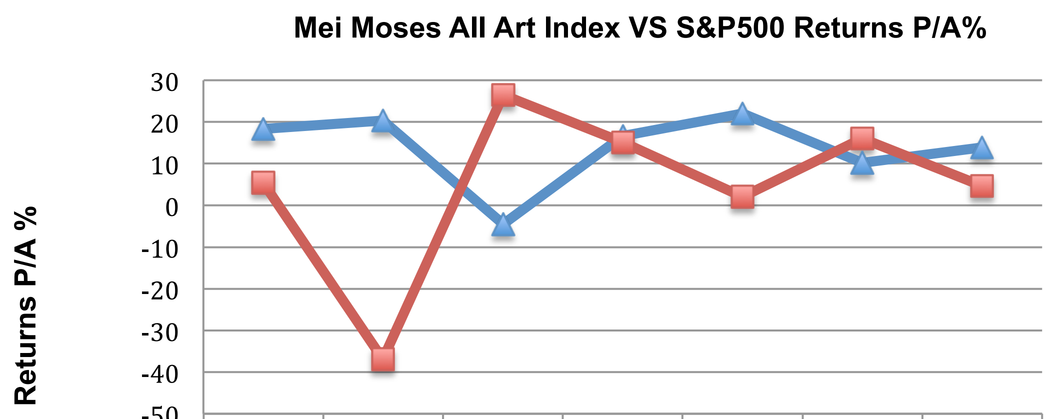
Source: Compiled by the Ludovic Dugué, based on Bialynicka-Birula, 2013

3.4. Art Indices

Art indices were created after art began to be considered as a financial tool. The financialisation of the art market allowed for their development. The two global major indices known today are the Mei Moses All Art Index and the AMR Index (Art Market Research).

The indices serve as a valuation tool; they generate an index number for all pieces of art on the market (a number that is determined by various factors, including sales price, genre and period). Art indices cover the contemporary, the impressionist and the post-war periods of art. This index follows the repeated-sales regression model (change in the sales price of the same object). The index, such as the Mei Moses one, only lists the public auctions from major auction houses. Obviously, this leads to a disparity in the world of art, since a huge part of trades are made privately through intermediaries or art dealers. On the table below, we can compare the returns generated by art and the stock options, thanks to the Mei Moses All Art Index and the S&P500.

Table 9: Mei Moses All Art Index VS S&P 500 Returns P/A%



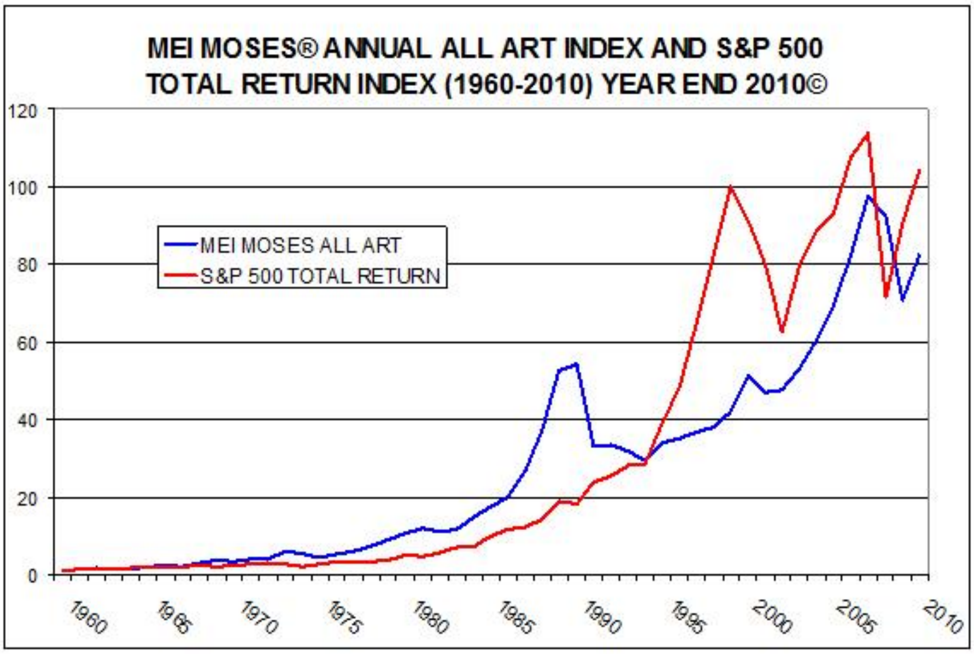
	2007	2008	2009	2010	2011	2012	Average 6 years
Mei Moses	18.27	20.4	-4.5	16.6	22	10.2	13.8
S&P 500	5.49	-37	26.46	15.06	2.12	16	4.7

Source: Compiled by Ludovic Dugué, based on Art Assure, 2013

We can see that the two indices are not really correlated and that there is, for example between 2008 and 2009, a time delay concerning the returns. According to Michael Moses, there is a time lag of 6 to 18 months over the art market when a financial crisis occurs (Art Assure 2013).

On the next page is a graph that represents the yields for art, with the Mei Moses index, compared to the Standard&Poor's 500. We can see that the two curves follow the same trend until the middle of the 1980s when the "Art Bubble" emerged. Moreover, we can see that the most recent financial crisis affected the biggest companies in the USA more than it affected the art market. It was actually impacted in the following months, as is visible on the previous chart.

Table 10: Total Return Index (Mei Moses & S&P 500) – Period 1960-2010



Source: Mei&Moses, www.artasanasset.com

3.4.1. Shortcoming of Indices

Most people are not thrilled by these indices. Indeed, the different indices available online do not reflect the reality of the art market, since they only identify the 500 most valuable artists in terms of volume of sales during auctions. Thus, their pertinence can be distorted. Investors do refer to these indices, however they do so only to confirm what they expected or for consultation purposes only. The market is so illiquid that it is difficult to trust indices blindly.

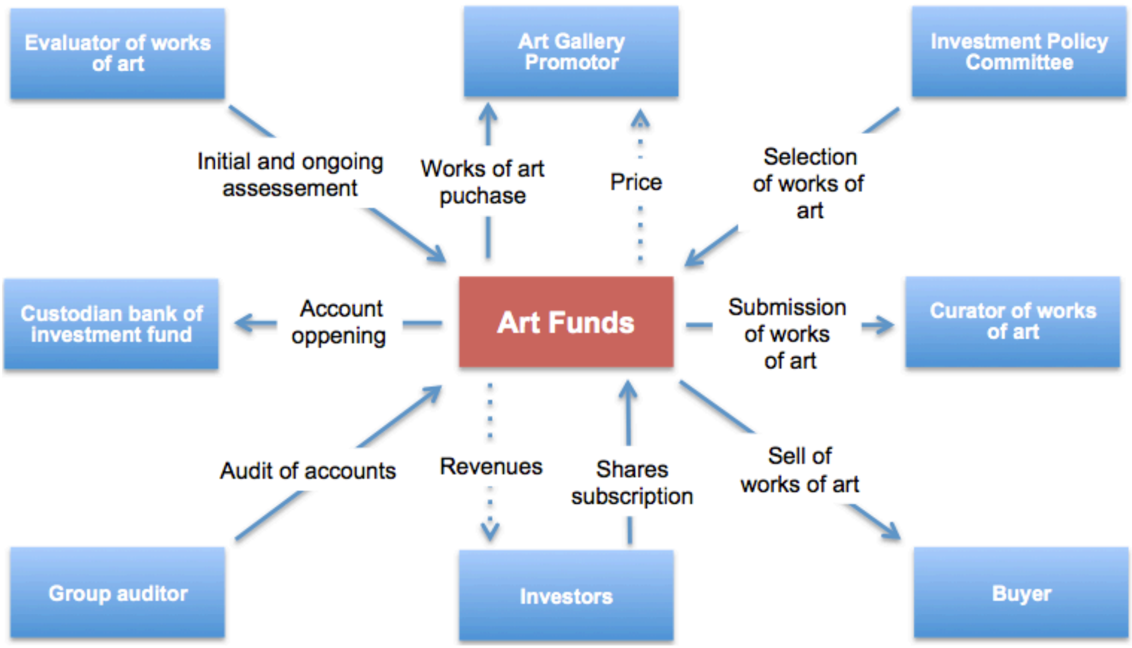
Additionally, the figures given by indices are contestable, since the methodology to construct such indices is yet not clear and, as said previously, the benchmark to create indices is only based over the most excellent performances. There is a selection bias within all the indices. The different indices available over the market are constructed over published transactions from auction houses and it is evident that famous artists are overrepresented in the auction houses. Nevertheless, the art market is a growing market and the returns are definitely positive.

3.5. Art Funds

The very first art fund created by a French financier, was named “La Peau de l’Ours” in 1904. From there, art funds have multiplied around the globe. The British Rail Pension generated an 11.3% annual compounded rate between 1974 and 1999 (Radell 2014). There also existed the Art Collection Fund, Artvest and the Fine Art Fund Group for example, which I will describe in greater detail in the following sub-chapter.

As we can see below, art funds collaborate with many parties. We can determine, thanks to the figure, the different parties that are gravitating around and their flows.

Figure 4: Environment of Art Funds



Source: Compiled by Ludovic Dugué, adapted from Juris art etc, 2014

As previously stated, investing in art is considered an alternative type of investment. Art funds manage a wide inventory of artworks collections; they can be compared to private equity funds since their strategies are about assets valuations. The difference lies in the heterogeneity of the objects. Indeed, an art fund holds an inventory with numerous works of arts that are highly varied. The size of a painting, the artist's name and so on vary from one another. Thus, the profit generated will depend on single artworks and not the entire portfolio. Although an art fund owns a wide range of artworks, a solid expertise and valuation must be achieved for every single works of art, in order to generate profitable returns. According to Victor Wiener, the founder of Victor Wiener Associates, there are different criteria that must be taken into account in order to set a methodology to assess the net asset value for an art fund.

1. The Quantitative Approach
2. The Qualitative Approach
3. The Types of Value
4. The Types of Marketplace
5. The Date of Purchase
6. The Aesthetic Factors
7. The Objective Economic Parameters (Wiener 2010)

Challenge - Risk

Art funds face many risks and challenges. Issues such as the valuation, the lack of liquidity, the paucity of track records (for some) and the unregulated situation of the market tend to reappear systematically. Moreover, because of the high volatility situation of the art market, art funds are affected by the difficulty to mark-to-markets the works of art.

Model

As mentioned above, the art funds used to, and still tend to follow the model of private equity funds (Tully 2011). However, art funds have lately decided to follow a wiser methodology, which consists of following a traditional alternative investment. A traditional alternative investment does not deal with bonds or stocks, but is more likely to deal with real estate or commodities, which is the most similar in nature.

Strategies

The strategies adopted by art funds can vary depending on the will of the art fund's manager. In this respect, art funds have the option to adopt a wide variety of strategies, since regulations over the latter are very limited or quasi non-existent i.e.: "buy and hold", "geographic arbitrage", "regional art", "period", "artwork driven", "emerging artists", "intrinsic value" (where there is a real opportunity to buy art at a very low price), "leveraging", "distressed art", "co-ownership", "showcasing", "bulk buying" and "medium" strategy[7].

Costs

Art funds contain many implied costs. There are the management fees lying between 1.5% and 3% of the amount invested by the investor (Kim 2013). Other costs that need to be taken into consideration are costs related to the fund operating expense, storage, transportation, insurance, expertise for purchase and sales. Finally, there is a 20% "tax" that is collected over each profit (Kim 2013).

[7] ARTFA, The Art Fund Association

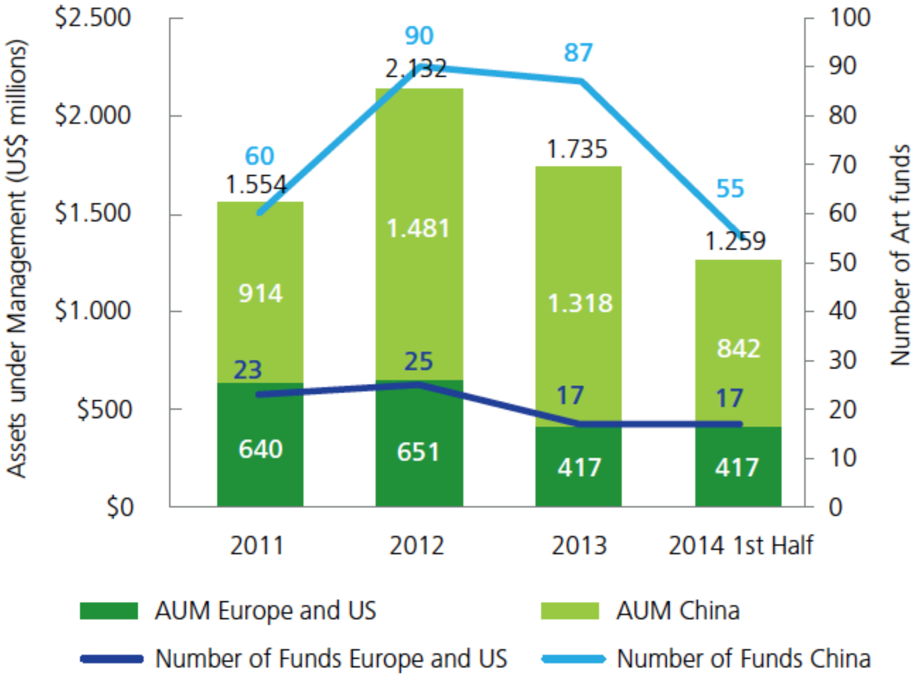
Rates of Return - Profit

In order to participate in an art fund, investors shall invest a sum that varies between 50'000 to 500'000 US dollars. Participants' amounts are confined for a period determined by the fund's manager (Powley 2013).

Despite the availability of art indices, one can argue that the possibilities of predicting rates of return are very weak. In this respect, the valuation of artworks is too subjective and the techniques to predict the rates of return would be considered artificial. Nevertheless, art funds developed specific techniques that vary among the funds. There can be techniques related to a certain creative approach, a statistical mix or even a curatorial expertise. Hence, through research, it is often possible to find out what the rates of return offered to investors are. The annual return provided by art funds is assumed to be between 6% and 12%, and the percentage retrieved from profit of the sale of artworks is amounted to 20% (Kim 2013). Moreover, concerning the Fine Art Fund Group, the founder Philip Hoffman ensures that for every 19th sales of art that generated a profit, only 1 of them is at a loss (Hoffman 2015).

The table on the next page shows the number of art funds and the total of assets under management for the period between 2011 and 2014 (1st half). As we can see, in 2012 the number of art funds reached its peak with 115 of them for a total of assets under management amounted to 2'132 million US dollars. Since then, there has been a clear decrease for both the AUM and numbers of art funds. In fact, this decrease is mainly due to stricter regulations from the Chinese government. Hence, global art funds are very limited in number, these days

Table 11: Global Art Investment Fund Market 2011 – 2014 1st Half



Source: Deloitte, Art & Finance Report (2014, p. 94)

3.5.1. The Fine Art Fund Group - Case Study

The Fine Art Fund Group was established in 2001 and is currently headed by the famous Philip Hoffman. Hoffman is the founder and the CEO, and was previously Christie's financial director, a position he held for 12 years. In 2003, the Fine Art Fund Group had assets under management (AUM) totaling 10 million US dollars; nowadays the overall AUM is amounted to 500 million US dollars. The art fund managed to generate substantial return amounted to 25.5% during its first few years (Hoffman 2015).

Philip Hoffman states that the value is necessary to art investment funds, because investors would redeem not only on the realized assets but also probably on some valuation of the assets.

Some key statistics from the group[8]

- It holds a strong 12-years track record in art
- It possesses assets under contract totaling more than 300 million US dollars
- It has investors in approximately 23 countries

[8] Hoffman, Philip, Cycle de Conférences Art Finance and Law, 2015

- The team is composed of more than 40 art and finance specialists based in numerous countries
- It actually raised the largest art fund globally
- The gross IRR (internal rate of return) per annum on realized assets is amounted to 16.46%
- The gross IRR per annum on realized and unrealized assets is amounted to 9.82%

<u>What does the group provide to its investors?</u>[9]

- Customized art advisory, curatorial advices, decorative services
- Personal fund management
- Minimizes costs; reduced or no transaction fees
- Gives access to exclusive private and public deals
- Gives access to a unique, global team combining art and finance expertise
- Guarantees the anonymity
- Gives access to the “community” and VIP events

[9] Hoffman, Philip, Cycle de Conférences Art Finance and Law, 2015

Profitable Deals

Table 12: The Fine Art Fund Group – Example Deals

Modern Painting	**Purchased 2006**	**$ 1.1 mio**
	Sold 2007	$ 2.3 mio
	Profit	$ 1.2 mio
	Cash on cash return	125%

Impressionist Painting	**Purchased 2010**	**$ 360'500**
	Sold 2010	$ 620'000
	Profit	$ 259'500
	Cash on cash return	70%

Old Master Painting	**Purchased 2010**	**$ 9.1 mio**
	Sold 2012	$ 11.5 mio
	Profit	$ 2.4 mio
	Cash on cash return	26%

Impressionist Sculpture	**Purchased 2007**	**$ 1.9 mio**
	Sold 2008	$ 2.4 mio
	Profit	$ 500'000
	Cash on cash return	26.32%

Modern Painting	**Purchased 2004**	**$ 1.5 mio**
	Sold 2011	$ 2.9 mio
	Profit	$ 1.4 mio
	Cash on cash return	91%

Source: Compiled by Ludovic Dugué, adapted from Risks, Rules, and Opportunities in Art Investment, 2014

3.6. *Return on Investment*

The rates of return provided by art investment lie on average somewhere between 8% and 15%. However, these percentages, which are hard to predict, are subject to variation depending on the method of investing (direct or indirect). Works of art sold in auctions repeatedly achieve lower returns. This phenomenon was true of certain paintings from different periods, especially the Old Masters. Below, we can see the difference in return for art pieces of various periods and styles.

Table 13: Average Returns for the Period 1980-2006

	Average Annual Return	Average Annual Standard Deviation
General Art	6.56%	8.08%
Old Masters	5.52%	7.09%
Impressionism	6.30%	13.12%
Modern	7.55%	3.78%
Contemporary	9.00%	9.90%

Source: Compiled by Ludovic Dugué, based on CAMPBELL, R.A.J, 2008

Contemporary art generate the most revenue compare to Old Masters. This trend has been confirmed over recent years.

Investors can rely on rates of return calculated using the Mei Moses Index, however it must be noted that their calculations are based on public sales alone (i.e. auctions). Hence, according to Mei Moses Index, returns have an average of 7% for art sold above 1 million US dollars and are greater than 10% for those sold below 1 million US dollars (Tully 2013). These rates are evidently too subjective for any investors that are willing to buy an artwork through an art dealer. Moreover, according to Moses, returns generated by art sold below 100’000 US dollars tend to be much higher compared to artworks sold for 1 million of US dollars (Tully 2013).

3.6.1. Methodology

As seen below, there are several methods for calculating the return generated by works of art. The two principle methods most frequently used are the “repeat sales regression” method and the “hedonic regression” cited below (Bialynicka-Birula 2013).

Table 14: Determination Methods for Rates of Return

Method	Characteristics
Naïve price index (Average)	Average and median auction prices are taken into account
Repeat sales regression	Prices from single works of art traded. Change in prices for the same work of art at two different period in time
Hedonic regression	Provides an index’s values over works of art criterion, such as name’s artist, mensuration of artworks
Hybrid model	Same principles as a RSR model, however follow the HR structure. Instead of considering price changes of comparable items by pairing sales
2-step Hedonic approach	All auction records are taken into account

Source: Compiled by Ludovic Dugué, based on Bialynicka-Birula, 2013

In order to have a broader view with concrete numbers, below is a table showing the difference in returns for the top 100 US and UK artists, the global top 100 artists and the All Art Index. Here we compare returns, over a period of 26 years, depending on the method used i.e. Naïve Price Index and/or Repeat Sales Regression.

Table 15: Comparison of Returns using NPI and RSR Calculation Methods for the Period 1976-2002

	Naïve Price Index			Repeat Sales Regression
	US 100	***UK 100***	***Art 100***	***All Art Index***
Annual Average Return	8.26%	5.12%	5.27%	10.07%
Annual average standard deviation	15.86%	11.10%	17.11%	21.88%

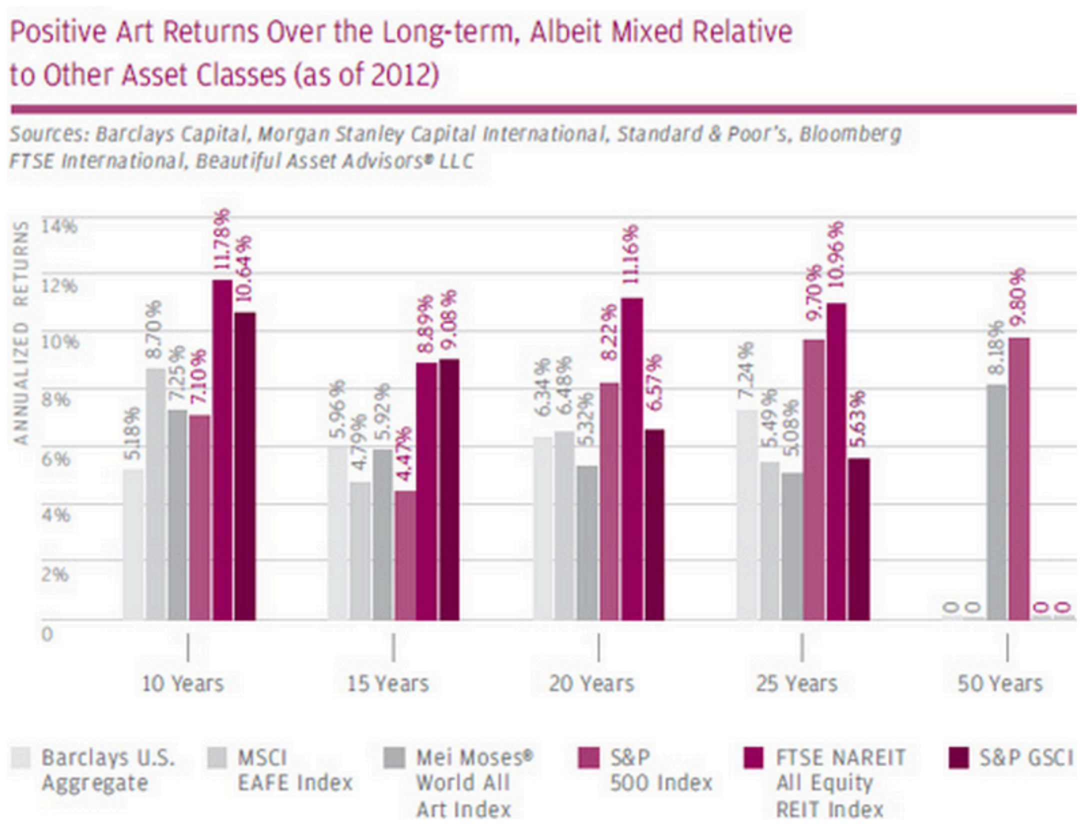
Source: Compiled by Ludovic Dugué, based on CAMPBELL, R.A.J, 2008

There is a clear asymmetry between the two methods used. Despite a nearly similar rate of return between the UK 100 and ART 100, the All Art Index shows almost twice the returns. Moreover, the standard deviation, interpreted as volatility, is much higher for the RSR method.

3.6.2. Art Returns Compared to Other Asset Classes

As analyzed, there are several methods for calculating returns on art investment, for instance, the Mei Moses World All Art Index. Due to the opacity of the art market and the difficulties in acquiring real data, the figure below helps contrast the different asset classes to art, and to define where art is situated among them over a medium to a long-term period.

Table 16: Positive Art Returns compared to other Asset Classes - 2012



Source: J.P. Morgan, 2013

In this figure, art's return is calculated using the Mei Moses World All Art Index. This figure gives us a compelling extensive overview, despite the shortcoming of this index cited previously. Surprisingly, the Mei Moses World All Art Index reaches 7.25%, only to collapse to 5.08%; a net drop of 42.7%. Nevertheless, when looking at the long-term period, it is interesting to note that the Mei Moses Index shows a considerable increase of 61% in rate of return to reach 8.18% when a work of art ages up to 50 years.

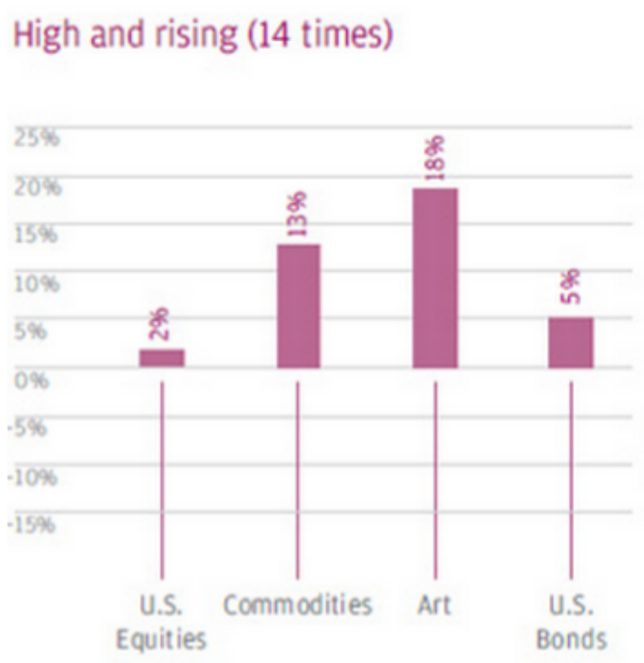
Art is known to have a low correlation with the stock market. However, we can notice that after 10 years, the S&P 500 Index is tightly join with it until the juncture of 15 years, however it increases sharply at 20 years and keep steady until 50 years with a slight increase.

3.6.3. Inflationist Period

During a period of inflation, art can be a valuable asset when investors are trying to hedge their fortune. Supposing that a country is affected by inflation, the rates of return and the interest are much likely to decrease. Although the former tends to decrease during an inflationary boom, commodities and art preform higher returns than expected. So much so that art is becoming a perfect "tool" to hedge one's wealth against inflation. According to J.P. Morgan, "*art has performed significantly better over the last 40 years during periods when inflation is rising, particularly high and rising*" (J.P. Morgan 2013).

The figure below shows that art is performing well during an inflationist period. It generates a positive return amounted to 18% compared to U.S Bonds and U.S Equities that perform poorly i.e. 5% and 2%.

Table 17: Returns in High and Rising Inflation for the Period 1973 – 2012



Source: J.P. Morgan, 2013

4. Discussion, from Risks to Recommendations

The central question of this project, which reappears constantly and on multiple stages of the art market, is the opacity and the lack of liquidity of the art market. With the help of the interviews and the research I conducted for this project, we can identify risks that to which investors can be exposed. By assessing these risks, recommendations will be provided on how best to minimize and mitigate them; hence trying to guarantee better returns.

4.1. The Risks of Investing in Art

When investing in art using the direct method, investors can be confronted with multiple types of risks. On the one hand, if an investor has the possibility of investing a large sum of money for a famous work, such as a Picasso, the risks will be reduced since the value has already been assessed and approved by many parties. On the other hand, if an investor is willing to invest in an emerging artist i.e. young artist, risks will obviously be much higher.

There are five elements that need to be taken into account in order to evaluate the risks. The table below lists them:

Table 18: Risks Related to Works of Art

Elements	Risks	Risks Characteristics
Works of art	Authenticity and Attribution	Uncertainty, paucity of certificates, fakes artworks, falsified
	Provenance	Uncertainty of the provenance, or factitious provenance
	Quality	Technical aspect, poor workmanship i.e. durability, quality of the objects
	Physical	Damages, destruction, poor storage condition, vandalism, loss and so on
Parties i.e. sellers and	Legal	Violation of legal regulations i.e. seller without property right, cheating, money laundering and others

buyers	Change	Change of tastes of the owner or seller
Auction / Agent	Agency	Level of knowledge from the agent, price manipulation
Immediate Environment	Market	Liquidity, difficulty to sell the object, change of costs (fees, taxes, licenses, market transactions). Change of legal regulations. Change of tastes and trends
Distant Environment	Economic	Change of trends, stock option, alternative investment
	Legal	Change of legal regulations
	Political	Conflicts on all sorts
	Force Majeure	Loss caused by natural disasters
	Crime	Vandalism, theft, illegal transactions

Source: Compiled by Ludovic Dugué, based on Bialynicka-Birula, 2013

The table above is very complete and clearly represents all the risks that an investor or a philanthropist can face. However, from an investor's point of view, two important factors are missing: levels of volatility and opacity of the current art market. Moreover, there are other aspects of risks that must be taken into account, which are not least important:

- Currency risks
- Government regulations - Legislation
- Faith and trust towards individuals
- Operational risks
- Valuation of artworks
- Diverse common risks linked to art funds (financial aspects)
- Title risks
- Liquidity risks

(Pearlstein & McCullough LLP 2014)

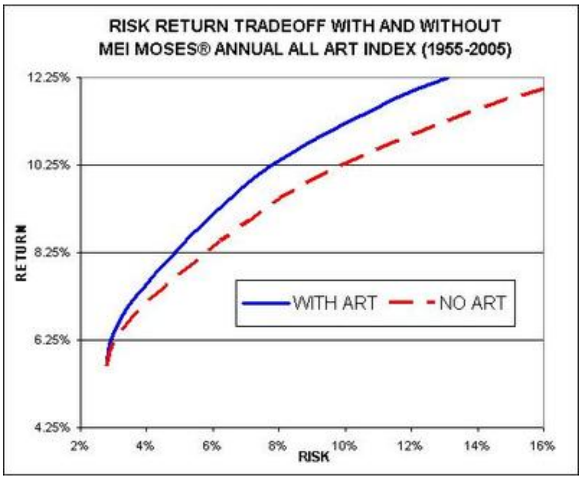
Hence, risks are also related to the financial side of the art market. As we determined previously, volatility i.e. standard deviation, can reach substantial heights depending on the amount invested for certain artworks and their respective periods and styles.

Furthermore, financial risks are correlated with two major aspects; the time period dedicated to the investment and the amount spent on artworks.

Investors often have great opportunities to affect and manipulate the price of art. Indeed, the art market is known to be unregulated with many private sales that remain unknown from the public. Thus, it is not unheard of for investors to come upon situations of art money laundering.

The figure below shows the correlation between an investment with and without art. Both investments are tightly correlated when the return and the risk are low. However, there is a significant separation when it comes to the increase of returns. As explained previously in the sub chapter related to Art Indices, the Mei Moses Index only takes into account public sales; hence the curve might act differently in situations where private sales are occurring.

Table 19: Risk Return Trade off with and without Mei Moses Annual All Art Index



Source: Artassure, 2013

4.2. *Auction Houses – Art Dealer Risks Assessment*

I conducted interviews with an art dealer from Paris, who also used to work in an auction house, and this first-hand research will assist in my assessment of the risks of dealing and investing in art.

In actuality, the current-day period is not stable enough to invest in art. Indeed, an art crisis may very well be imminent, a hypothesis based on the fact that the art market has been going well for the last seven years. Nowadays, many actors are unwilling to invest and even thinking about decreasing their invested sum, especially on young artists that are extremely speculative investments. The flows of investment of young artists are moving at a fast pace, which makes it difficult to minimize risks. Besides, the curve that illustrates the value of art is very short. Despite that, the value of art can increase rapidly and reach a peak in a short period, just as it can decline even faster.

Auction houses indeed have a monopolistic role. This state of being enables them to define the value of artworks. By doing so, it fosters their ability to speculate over certain period's time and govern the value of art for certain artists. Moreover, the art market deals with investors that are only looking for profit that is generated by investing in art. For example, investors often do not even display their purchases in their living rooms or homes, but store them in warehouse or free ports. All of these realities corroborate the speculative aspect of the art market. There is another risk to take into consideration, which is related to artwork that are bought and sold repeatedly. Indeed, when an investor is willing to buy a work of art that has been sold many times, the artwork's value tends to decrease sharply since the implication is that no one is willing to keep it and that desire for it is low.

It is important to distinguish the difference between art dealers and investors. They do not have the same action plan. However, the risk that comes with the timing of art purchases and sales can have similarities for both. The two parties try to buy or sell artworks in a time frame that enable them to generate profitable revenues while minimizing the risks. However, art dealers are more focused on short-term periods whereas investors tend to keep their purchases over a long-term period (for those using the direct investment method in general).

4.3. Art Collectors Risks Assessment

In order to grasp the activity of a family office focused in art management, I had the chance to interview the manager of a family office based in Geneva.

The family office in question started its service in order to advise and manage the art portfolio of their client, which is a collector. It is important to denote that this particular client does not have a financial perspective on art. We can call the person an art passionate, acting with a philanthropic point of view. Supposing that the sale of a work of art generates a profit, the revenue would be automatically reinvested into their private fund in order to perpetuate their activity. The collector's fund is mainly dedicated to circular reinvestment in the purpose of owning an increasingly number of artworks. As the manager said during the interview, the office considers art as a tool of diversification for the portfolio of their client. In terms of division of labour, the manager is only focusing on the art management for the overall art collection while the collector decided himself about the style of artworks he is willing to purchase. This interview enabled me to gain a broader view of this kind of entity and to understand their goals within the art market.

Both interviews showed that the opinions of the art dealer and the manager of this family office converge on the current situation of the art market; it is increasingly unstable. Inordinate and absurd amounts of money are invested in order to purchase works of art. Moreover, both parties seem to agree that the current situation of the art market might crash soon. It has now been a too long period in which, investors have been willing to invest such unquantifiable amounts of money into art, in effect rendering art priceless.

Risks related to art must not be neglected, as it is so tied to the tides of the overall economic market. All things considered, the risks related to art are very marginal for this art collector, since his objectives are effectively unrelated to pure profit creation but for passion.

Concerning the predictability of an artwork, the manager esteemed that during the 1980s, just before the “Art Bubble”, it was much easier to predict prices of works by famous artists. This has long since been nearly impossible. Nevertheless, even if art is not an exact science, predictive tools make this less of a guessing game. Investors have the possibility of following trends with the information available on the market.

4.4. Recommendations

After analyzing the risks that investors can be confronted with, final recommendations are given below on how to mitigate these potential risks for anyone willing to invest in art. As established through this paper, the art market is a bumpy and unregulated playing field, which is extremely difficult to grasp for art dealers, let alone an inexperienced investor. Evidently, risks cannot be eliminated altogether because of the complexity of the market. Nevertheless, the recommendations provided should reduce the risks linked to the volatility and the opacity of the art market.

4.4.1. Preparation

Whenever an investor is thinking about investing in art, whether it is through direct or indirect investment, there are few steps to consider. Indeed, investors should first understand how the art market is moving and acting, while considering its latest trends and its regulations. The market includes innumerable actors, so it is necessary to have a global view of it. Of course, grasping what is hidden within it can be very tricky, since there are so many niche players that influence the art market. Thus investors must, in the first instance, encompass all the crucial information given by art actors and try to educate themselves about the art market, especially for direct investments. Although indirect investment requires important amounts of money, direct investment requires more preparation. For example, if investors are more focused one contemporary art, they should educate themselves about the history of it i.e. artists, history, and so on.

4.4.2. Determining the Role of each Actor

As previously established, the market is flooded with numerous actors; artists, galleries, museums, auction houses, collectors, investors, speculators, dealers, agents, advisors and so on. Each of their roles is very distinct but can converge depending on the situation. An investor must have a proper understanding of the role each these actors play in order to mitigate risks, especially because each player has specific objectives. For instance, galleries do not sell art to anyone. Even if the investor is able to purchase the good, the gallery could refuse. It would instead prioritize certain clients who have influence over the art market. Some galleries call specific individuals directly to propose works of arts, especially for the primary market. Moreover, a work of art earns value during the time it is exposed in a gallery or museum. To take another example, if a museum curator decides to launch an exposition, he will ask a gallery to contact the person who bought the artwork in order to expose it. Hence, every time an artwork is publicly shown, either in a gallery or in a museum, it will rise in value, benefitting all players. Investors must be aware that of all these schemes happen on a daily basis. Because all actors have a different target in mind, the market acts dependently from them. Investors should also limit their purchases from very young artists. Doing so is extremely risky since the value is highly speculative; value can increase rapidly, but can also decrease even faster.

The art market includes many art influencers such as Stephan Simchowitz. Persons of interest like Simchowitz, who is a film producer, can influence the sale of quasi-value-less art through simple technological tools like Instagram. Such persons have a real impact over the art market that investors should consider to follow for informational purposes.

4.4.3. Participation in Events (Auctions, Fairs, Shows)

Every investor or person interested in buying art should participate in the different art fairs that exist. Having the possibility to visit such fairs, like Art Basel, minimizes the risks that investors can encounter. Firstly, because it is important to discuss with artists present at the fairs in order to get a « feel » of his work and his intention. Buying works of art with eyes closed and thinking that it will gain value is clearly not the best strategy. The key strategy is about information and extensive research. Every morsel of information and detail related to the artist are crucial to ensuring a successful investment. Moreover, independent advice from art dealers, gallery directors or even art agents should not be underestimated. Their advice is decisive for making the right choice concerning a potential investment, even more if investors are novices.

Furthermore, participating in auctions is an excellent way to form the investor's own opinion. Indeed, joining in auctions is essential to understanding how certain actors act in such circumstances and will increasing the investor's knowledge.

4.4.4. Data – Indices

As the art dealer said during the interview I conducted, indices are synonymous of big data. They can be useful to look at since they give intriguing information for the overall art market. Indices are based on a tremendous number of art deals. Hence, it should be used as informational and should not be neglected. Art dealers take these indices into account in order to confirm their deals. Investors can and therefore should access indices, as this will help them understand how the art market and its artists are performing.

Nevertheless, what indices propose might not be relevant for all investments, since only 48% of public sales[10] are recorded, which leaves out a majority of 52% of private sales. As a consequence of the high illiquidity of the art market, some actors do not like to refer to indices since only the 500 most valuable artists, in terms of volume of sales, are represented in indices. This might not be the true reflection of the art market. Finally, there are no trends when analyzing individual pieces.

4.4.5. Purchase - Invested Amount

When investing in art, it is primordial for investors to determine the sum they are willing to invest. Auctions can sometimes reach such peaks that it is important to define the price range investors are able or want to enter. Each artwork is valued at a certain price, which varies tremendously. Overall, if an investor is willing to generate high return, he should not buy highly priced art. When using the direct method of investment, the key strategy is the diversification of artworks. Moreover, because of the

[10] TULLY, Kathryn, Is Your Art An Investment?, 2012

liquidity risks, it is crucial not to put all the investments eggs in one basket, like any other investment types i.e. stocks.

With regard to indirect investments, as explained earlier, the minimum sum most invest with is 50'000 to 500'000 US dollars, on average. More than anything, this determines the nature of the art, which can be bought, which means that investors usually do not manage nor decide what epoch of art they will invest in.

4.4.6. Operational Risks Minimization and Management (Insurance, Certificates, Storage)

In order to minimize risks, investors must make sure about certain crucial factors: the origin and authenticity of the artwork (amongst others). Certificates exist that prove these criteria, and they are all the more essential for buyers to avoid dealing in falsified art. Once the work of art is bought, the buyer has to seriously consider where to put it, particularly if the artwork is intended for storage. Indeed, the value of art can decrease significantly by any small change in temperature, humidity or any external factors that can affect it. Hence, more costs must be foreseen.

Eventually, receiving concrete advices by specialists from all domains is crucial, since all countries do not yet apply strict regulations unanimously. Because falsified artworks can sometimes be indiscernible, the accreditation of trusted professional must be taken seriously.

4.4.7. Time-Frame

As cited previously, establishing a finite time period is essential when aiming for and generating profitable revenue. Having conducted research and interviews, it is usually advisable to have long-term focus to generate the highest returns. Investors always need to think long-term. On the other hand, one would argue that returns could also be attractive after a period of five to seven years.

When looking at the previous figure (number 12) depicting art returns as compared to other asset classes, the Mei Moses World All Art Index reaches its highest point after a period of 50 years with a return of 8.18%. However, depending on the way people invest in art, this could be achieved through direct or indirect investment (art funds), as returns can vary considerably. Art funds can attain more than 20% of returns in very few years of investment (i.e. short-term period).

4.4.8. Track Record - Valuations - Expertise

Every investor should seriously consider creating an art track record since valuation of an artwork is sometimes an arduous task. A track record enables investors and/or companies to better comprehend the art market but also to have a better view over artworks bought and how their value can change within a timeframe. From the perspective of an art fund, creating a track record is key to being successful, or at the very least, to minimize risks.

Because the art market is not an exact science, valuation is needed. It is seen as a key factor. In order to pay the “right” price, the valuation of artworks by an expert is crucial. This process helps to have a better idea of the liquidity of the art market. Yet, one would argue that applying the method of valuation by an expert would be too risky when considering that human emotion can be easily biased. To counter this, it is recommended to use an accurate mathematical/statistical approach delivered by a specialized company in the modeling of art investment.

4.4.9. Technology

Technology (the Internet, in particular) renders the art market more transparent. Indeed, buyers can go through online exchanges that are fairly liquid and of course have access to private sales. Moreover, investors have the possibility to considerably reduce the transaction costs applied by auction houses, which amounted in average to 25% of the total cost. Buyers are more confident about their purchases, as platforms enable the constriction of the bond between buyers and sellers. Moreover, it makes information available to all.

There exist diverse financial tools that are available to investors and/or collectors. Therefore, investors must simply ensure that the investment is made through the most accurate tool that would be the most adapted to the project, from a financial point of view.

4.4.10. Selling

Eventually, when investors are thinking about selling their purchases, there is not any magical solution. As any sorts of investment, the expression « buy low and sell high » is called. Selling artworks can be thorny; investors have to assess the duration of the investment alongside keeping a critical view of the marketplace. Art is about tastes and trends; hence finding the right geographical location and the right person to sell to may be more difficult than expected. Fortunately, investors can rely on art dealer or special agents in order to sell his artwork rapidly.

Conclusion

To conclude, this bachelor thesis focuses on how to reflect on the different ways art can be approached, whether through the lens of a passionate investor or through a purely financial investor's point of view. Analyzing the art market and its structure, the first two chapters helped pave the way for the third chapter, "Art as an investment", a logical question that arises from this analysis. Lastly, I assessed the risks and recommendations faced by those who invest in art.

With this thesis in mind, I researched how the art market acted from the 1980s until now and detailed this progression with the help of art reports, explaining their influence, identifying different actors, distinguishing between the two primary methods of investing in art (the direct and indirect methods), and defining the role of art funds, indices, returns on investment and the implied risks of investing in art. Moreover, the two interviews that I arranged helped me to gain a better understanding of this complex market and how it is structured, particularly with regard to the role of the two biggest auctions houses and the influential position they benefit from.

There have already been a lot of studies over the years about returns generated by art along the different periods. These multiple works are mainly focused on big data collection trying to establish a concrete numerical rate of returns through mathematical and statistical approaches. Nevertheless, as I said, art investment is not an exact science; no one can fully predict the future of any individual work of art, but only that the value of a work of art will always vary depending on certain factors. Consequently, with the help of this bachelor thesis, I aimed to understand the different approaches of investing in art, its implications and finally mitigate risks that investors face on daily basis thanks to practical recommendation. My research was done in such a way that I was able to filter important information while narrowing down my findings. Furthermore, my findings about recommendations are related to the:

- Preparation
- Role of each actors
- Data and indices
- Amount invested
- Decrease in risks through crucial factors (i.e. certificates among others)
- Time-Frame
- Track records / Valuation / Expertise
- Technology
- Selling

In my opinion, information is the key element; asking professionals working in the field is the best method to guide art investors in the right path. These are necessities to enable efficient, profitable and least risky returns on art investment. Moreover, in my opinion there is the possibility that the art investment method change over the years. Artworks might be considered in the near future as a simple commodity where the value and the selling price would be defined and used as a « future ».

Finally, I really enjoyed researching for and writing this Bachelor thesis. I learned that investing in art can be very tricky unless the investment is done with an art-passionate point of view. As one person said during their interview, “At least, there will not be any regret if the value of a purchased artwork would tend to decrease with the time”. Hence, the final personal proposal I would give to anyone willing to invest in art would be:

“Buy works of art that you love”.

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Appendix

Interview with X – 22nd April 2015

The person X is currently employed in a Family Office, dedicated for art collection

The person Y is the art collector.

1. **How would you define the actual dynamism of the art market?**

I would say to that the market is getting crazy. Investing such large amount of money sometimes is just non-realistic. I would not be surprised that the market would crash again soon. It is now being a long time that the amounts of money invested into the art market reach substantial peak.

2. **Which situation (place) did the family offices, dedicated to art collection, take in the art market lately?**

The collector acquires about one to three contemporary art objects per month. Obviously, I think that the collector acts and influences indirectly a part of the art market.

3. **What were the encouragements to create this/the Family Offices(s)?**

This family office was created in order to take care of the asset of the art collector to manage art data, insurances for the works of arts, transportation, inventories, art loans and other administrative tasks.

   a. **For philanthropy or pure investment purpose?**

My client acquires works of art only for a philanthropist point of view. However, if the collector creates a profit over a work of art, the profit will be reinvested into the art fund.

4. **How would you define the will and the intentions of the art collector?**

It started thanks to passion for art from the collector. There is not really a financial profit perspective. The collector supports many emerging artists in order to help them developing their arts. For example, every year Y is organizing a show, mainly hosting young artists that are starting their careers, to whom he has full trust. He also contributes to art school, art foundations.

5. **Do you think that renown works of art, such as a Picasso for example, that Y might have bought a long time ago would have a direct impact on the art market when it is available for sale ?**

Indeed, when an important artwork comes back on the market, which would have been displayed several times in museums but not in the art market for example, it creates a strong interest from buyers.

6. **What does deliver the family office to the collector?**

We provide administrative and management services such as track records, documentations, valuation, inventory, insurances, transportation, art loans and so on.

7. **What are the expectations from the collector?**

That his assets are well managed and that he can be relieved from administrative tasks in order to better focus on the art world.

8. **Does the Family Office offer an evaluation, an expert assessment for the works of arts before and after the purchase?**

We do provide these sorts of service. The collector would ask for professional advices from third parties. The collector has his own privileged art experts that would propose this kind of services.

9. **Do you think that there is an increasing trend about the creation Family offices dedicated to works of art, globally speaking, compare to art funds for example?**

Since there are more fortunate people, those people would tend to create their own art collection, rather than investing through art funds.

10. **What are the investment strategies for a short, medium and long-term period?**

In our case, there is not really an investment strategy since our client buys art for passion. However, I would say that if one is looking for profit, he better has to concentrate his asset investments over a long-term period.

11. Could you define some risks incurred by an art collector?

There can have many risks or situations that would alter the value of an artwork. For example, not insuring work of arts to their real values, damages, accident or even losses.

a. How to minimize, mitigate the risks?

One of the most important things to do is to expertise artworks in order that they are properly insured.

Moreover, insurances permit to the company to reassess the works of arts. Because a work of art that for example would have been valued at USD 2mio in 1985-1986 would then, because of the crisis, only be valued at USD 1.5 mio.

b. How can the family office stay profitable knowing that the market opacity is quite important?

This question is not relevant since in our case we do not have any kind of investment strategy.

12. Do you have a concrete example of a profitable return on investment concerning a work of art?

Yes, once an important artwork was sold 80 times its acquisition price.

13. Which strategies did the Family Office or the collector adopts, in order to generate profitable revenue?

We cannot say that it was a strategy from the collector, however it necessary in order to generate available cash for future acquisitions.

14. Could you give me a concrete example of an unprofitable "investment"?

The last example that comes into my mind was the purchased in 1998 of an installation (a video with a TV screen) purchased for 1800 pounds, which has been sold recently for 100 pounds. Because the technology improves very fast, I would say that the obsolescence was one of the main reasons. The obvious other reason resides in the choice of the artist in that case.

Commissioned artworks may also decrease over time since there are tailored made and would hardly be of any interest for other art collectors (collector's portrait made by the artist for example)

15. Do you think that an investment for a work of art will always be profitable?

I think I would answer no, because it all depends of the choice you make. No one can be totally certain of the predictability of a work of art.

16. Do you think that profitable return on investment will always be predictable?

In the above-mentioned example, at the time of the sale of the artwork, the profit was predictable because the artist who made this artwork became famous by the time. However when the collector decided to purchase that work 30 years ago, the artist was not yet known and famous, hence there was no real predictability obviously.

It is not an exact science. You have to take into account that it is also influenced by the phenomena of the trends. For example, a work of art that was fancy in the 1980s is not necessarily trendy now.

17. What recommendation would you give to futures, others family offices or art collectors?

To always purchase for the sake of passion and with a philanthropic point of view. Hopefully, there will not be any regret by the buyer in case his acquisition is not fructuous. Another recommendation would be to record all the information concerning each work of art acquired (provenance, documentations, exhibition, bibliography…). Every time I have the possibility to track more information about the object, I record it carefully.

An annual expertise of the art collection is recommended in order to insure works of art at their real value; neither under estimate, nor over estimates it. It happened that a fire destroyed a storage place where several pieces were placed. The works of art were lost and since there were not correctly/properly insured, the loss was not only financial but also emotional.

Taking good care of the works of art during transportation, and take all the necessary precautions in case of loan to a museum.

Finally, having the possibility to meet and learn from and about the artist is always a plus in order to reduce the risks. It is also important to follow the trends of the art market and observe the influencers as well as the other art collectors.

Interview with X – 29th April 2015

Interview with X, former employee in a Parisian auction house and currently working as an independent art dealer.

1. **How would you define the actual dynamism of the art market?**

There is a substantial crisis that is about to happen, a cyclical crisis. Now it has been seven years that the market is going pretty well. In my thought, it is not the good period to invest in arts; it would be better to wait until the end of 2016. The actual prices overtook the 2008 prices, 2008 that was the end of the crisis and 2009 the gigantic crisis. I would say that now we reach records, overtook volumes. Incidentally, we could feel this actual tension since many markets are not willing to invest, decreasing their investment, especially on young artists that are very speculative investments. On the other hand, if you are willing to sell a work of art from Francis Bacon, you will not have any difficulties to sell it, safe havens are still safe havens. People do not want to speculate over young artists, it is now too risky and it is going very fast.

2. **Which situation (place) did the auction houses take in art lately?**

They take almost all the available space, since they do auctions and private sales too. For example, Christie's is loosing money on the auctions, but is making profit on the private sales. They have a lot of structural costs. They are global companies with powerful range of actions that is why, us art dealers, have difficulties to cope with them.

   a. **What were the encouragements to create auction houses**

Obviously, the auction houses were created de facto with the supply and demand. Their financial power was exponential. They have billion that come from investment funds, in order to develop the company.

3. **What are, based on your knowledge, the impacts that were created from the auction houses?**

The auction houses could make the sun shine or make it rain. They have a monopolistic situation; they define the values of works of art. They create magazine for their auction, and if they decided to make 10 pages for one single artist and that you have two experts that say that he will be the new Warhol, hence the value will tend to go high. For my perspective, I am dealing with one person, the auction houses are dealing with numerous buyers and sellers. They have a lot of infrastructure in order to be connected with the stakeholders, by email, magazine, fax, Internet and so on. If you are on an island, there will not be any problem about buying your Francis Bacon.

4. **How would you define your current work as an art dealer?**

I do deals. Compared to auction houses, I guarantee the anonymity of the two parties. I do exactly the same as auction houses apart from that I speak to only one person. I am an intermediate between the private parties, or between galleries and auctioneer. I refer myself a lot to auction houses, the current values of works of art in order to stay correct with the prices. The rarity has obviously to be taken into account among other factors.

5. **What were the motivations to become an art dealer?**

My passion for the artworks and the money.

6. **What is your added value towards art buyers compare to online auction houses?**

Primarily, I guarantee the anonymity between parties. I would never say who is buying and selling. It is faster, most of the time I guarantee that you will be able to sell it. The work of art stays fresh. It will not circulate on the market; I only show it to one or two interested persons.

7. **What are the buyers' expectations?**

Buying the work of art at the lowest price possible. The buyers I deal with represent 50% of investors and 50% of passionate. For example, I have bankers in my entourage that buy arts to only store it in the free port, sometimes they do not even know what kind of art is it. They just know that they have to buy this artist in order to generate revenues. In this speculative period, everyone wants the same artist at the same time.

8. **Do you offer, to your buyers, an expertise for the works of art?**

I would say that, since I am working in this field, you have a lot of available information; we have ears everywhere, concerning the prices, who is buying, who is selling, what is being sold, if the price is inflated.

It is like a financial market, but totally deregulate. The rules on insider dealer are entirely incentivized. I think that very soon, it will have to be stopped and that rules would be put in place in order to regulate the market.

9. **Do you think that there is an increasing will about participating to art auction?**

Absolutely, now everyone is going to auctions. It is becoming a very social place to be. There are art auctions twice per year in New York and twice per year in London over 5 days.

10. **What are the buyers' strategies over a short, medium and long-term period?**

The short term is now too risky, I advise you not to buy for a short-term period. For my point of view, it happened that I sold a work of art after 6 month or 2 days. However, for someone who is not in the art field, he should wait at least 3 years before doing something.

11. **How would you compare the investor and the passionate?**

The age. Young people are more into speculation. However, I think there are not specific profiles.

12. **What are, based on your experience, the risks for buyers and sellers?**

The risks would be to loose everything. It could come from the fact that they buy too much, or that they hear just a little bit too late the name of the artist, hence they cannot buy it, and then will pay high price in order to get the work of art. The curve for values, is very short, the value can increase very fast and very high but drop even more quickly.

   a. **How to minimize, mitigate risks related to art?**

By buying over a long-term period, saying that we will not sell it right away. You have to wait at least 5, 10 or 15 years; there are no limits to it. You have to be rigorous about your search, visit healthy galleries that have museum behind and curators behind.

Never over pay for a work of art and do not listen to rumors. And always be careful about young artists. You have to know about the art history, the different periods. Never go alone when you are willing to buy a work of art, you can trust an advisor or a gallery owner that will explain you why to buy this art and guide you to buy at the right price.

b. How can you stay profitable knowing that the market opacity is quite strong?

Do not follow the trend and do not listen to rumors. You have to buy arts from artists that will go down in history of art. Obviously do not buy art, which is valued at its peak.

13. Do you have a concrete example of a profitable return on investment concerning a work of art?

I bought a work of art from Lucien Smith at $9000, and one year later I was able to sell it at $300’000. Another I bought at $5000 and sold it at $115’000 over a 6 month period.

14. Could you give me a concrete example of an unprofitable “investment”?

It depends of the period you are willing to sell a work of art. When I was working in Shanghai and Beijing, during the financial crisis, the market was totally down. Nobody was willing to buy any kind of art.

15. Do you think that an investment for a work of art will always be profitable over a short, medium and long-term period?

Roughly speaking, yes if you choose the right works of art. Whether the work of art will gently disappeared or the market will stagnate. Loosing money over a famous work of art is very complicated. I do not see how you can loose money over a famous artist. Over a short-term period you probably might loose some money like the stock option. Over 5 years, a medium-term period, it is becoming more serious and your risk to loose money is decreasing.

16. Are your goals of sales, most of time, reached?

I will never know about this until the work of art is sold.

17. **What art (periods) generates the most returns?**

The contemporary art is the art that generate the best returns. And for the best stability, it is more the ancient and modern art.

18. **What art generates the least returns?**

I would say that it is most of the time the young artists because it is so risky. During auctions, values for works of art are mostly stable, especially for known artists.

19. **During an auction, what would be the proportion of sales for the overall lots? Are there a lot of unsold articles?**

For the night sales, there are hardly unsold article, 95% of the works of art are sold. Concerning the day-sales, there are much more lots, thus much more unsold articles

20. **Do you consider that most of the buyers and sellers are "experts/connoisseur"?**

No, absolutely not. Aside from niche market where buyers know exactly what they want.

21. **What are their goals for short, medium, long-term period?**

Most of the time, their goals are in short-term to generate a profit, especially for contemporary arts.

22. **What is your opinion about art indices?**

There are big data. They have list of the 500 most valuable artists in term of volume of sales, however what they base themselves on are not relevant. Sometimes I do refer myself to these indices, however it is just as information and most of the time I do not trust them, because the art market is too illiquid.

23. **Michael Moses, the co-founder of the famous Mei&Moses Index, consider that the more under prices a work of art is sold compare to its forecast, the more its price will tend to diminish over the time, what do you reckon about this statement?**

Yes I can confirm this statement.

24. **Do you think that works of art estimate under $100’000 would tend to create a better return on investment compared to these estimate over $100’000, and $1mio?**

Not really. You can have a bigger multiple when buying a work of art that is valued under $100’000. The chances that the object would gain value over time is greater than an objects valued over $100’000.

25. **Would you say that works of art sold repeatedly, would have a weak future prospect? Will they always find a buyer?**

A work of art that is sold repeatedly is condemned not to give profit. Moreover, its value will decrease very fast since no one is willing to keep it.

26. **Do you estimate that there is a global increase in speculation because of the current opacity of the art market?**

It is becoming less and less opaque. The information concerning the work of art is shifting very fast around the globe. It is very easy to get the value of any work of art. Internet is helping to the speculation. Thus the value of a work of art can be decreasing rapidly.

27. **Do you think that artprice.net (the online auction house), affects your work? Do people are more aware of the art market?**

Quite the opposite actually, the art market over Internet helps the market fluidity; it gives the right and real information to everyone.

Regulation of Art Investment Fund in Switzerland[11]

As we are situated in Switzerland, I will describe below some interesting regulations that are applied on art investment funds and how it affects the Swiss art market:

First of all, the main regulation for art investment funds is called the Swiss Collective Investment Scheme Act. Under this act, there are three requirements for a legal entity to be characterized as an investment scheme:

1. The number of investors pulling an asset must be more than two.
2. Assets must be managed collectively for purposes of achieving a return.
3. A third party must manage the asset. The investor pulls its asset into a vehicle to be managed by the third party.

As such, the Swiss investment vehicle is supervised by the FINMA (Swiss Market Supervisory Authority). Below are the four types of legal institutions that are available to structure the proposed investment:

1. Contractual investments funds
2. Investment companies with variable capital
3. Investment company with fixed capital
4. Swiss limited partnerships for collective investment

Investment Schemes

Here, we will differentiate between open-ended and close-ended investment schemes:

Open-Ended Investment Schemes:

- Investors benefit from an almost immediate redemption right. At any point in time during the time of the investment, the investor might redeem its interests, meaning giving back its interest to the promoter of the investment scheme and getting back its initial investment along with the profit. Thus, these assets must be liquid in order for the promoter to generate cash.

Close-Ended Collective Investment Schemes for More Security

- In a collective investment scheme, investors do not have the possibility to exit investments at any point in time; they are subjected to a number of restrictions to exit these investments. Most of the time, they must wait until the end of the

[11] Fisher, Philipp, Cycle de Conférences Art Finance and Law, 2015

investment cycle of the liquidation of the vehicle or they must try to find a buyer for its interest on the secondary market.

Distribution of the interests in an art investment fund

There are 3 sets of rules that need to be taken into account upon distributing or offering interest in financial securities, which are linked to the value of an artwork.

1. Rules dealing with the public offering of debt or equity securities
2. Rules applicable to the distribution of structured product
3. Rules gathering the distribution of interests in non-Swiss collective investment scheme

The application of these three rules relies on two factors.

1. The nature of the interest or the security which is being offered to the Swiss based investor
2. The characteristics and numbers of the Swiss based investors

Alongside, the offering of the interest to as Swiss-based investor triggers these rules. Thus, we have to determine the three types of investors.

- Supervise qualified investors (banks, securities dealers and insurance companies)
- Ordinary qualified investors (institutions: pension funds, individuals)
- Retail investors

To be noted that the offering of structured products in Switzerland is not subject to any regulation for supervised qualified investors and ordinary qualified investors.

However, if the offering is made to retail investors, there is the requirement to prepare a so-called simplified prospectus and other requirements before these structured products are offered to Swiss-based investors.

Offering of Collective Interest in Collective Investment Scheme in Switzerland

There are 3 situations where the promoter of a collective investment scheme such as an art fund must take into account before marketing the collective investment fund in Switzerland:

1. Supervise qualified investors (if the offering is created to supervise qualified investors, it is deemed to be a placement not a distribution. Thus no regulations apply).
2. Ordinary qualified investors: light regulations. The products and the art investment fund do not have to be formally register, but must appoint a Swiss representative.
3. Full fledge Swiss regulatory framework dealing with collective investment scheme enter into force as soon as non-qualified investors (retail investors). Retail investors can only be approached if the non-Swiss collective investment scheme, like the art fund, has been formally authorized by FINMA.